

Japan's Economy and Monetary Policy

Speech at a Meeting with Business Leaders in Ishikawa

September 10, 2014

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Chart 1

Real GDP Growth

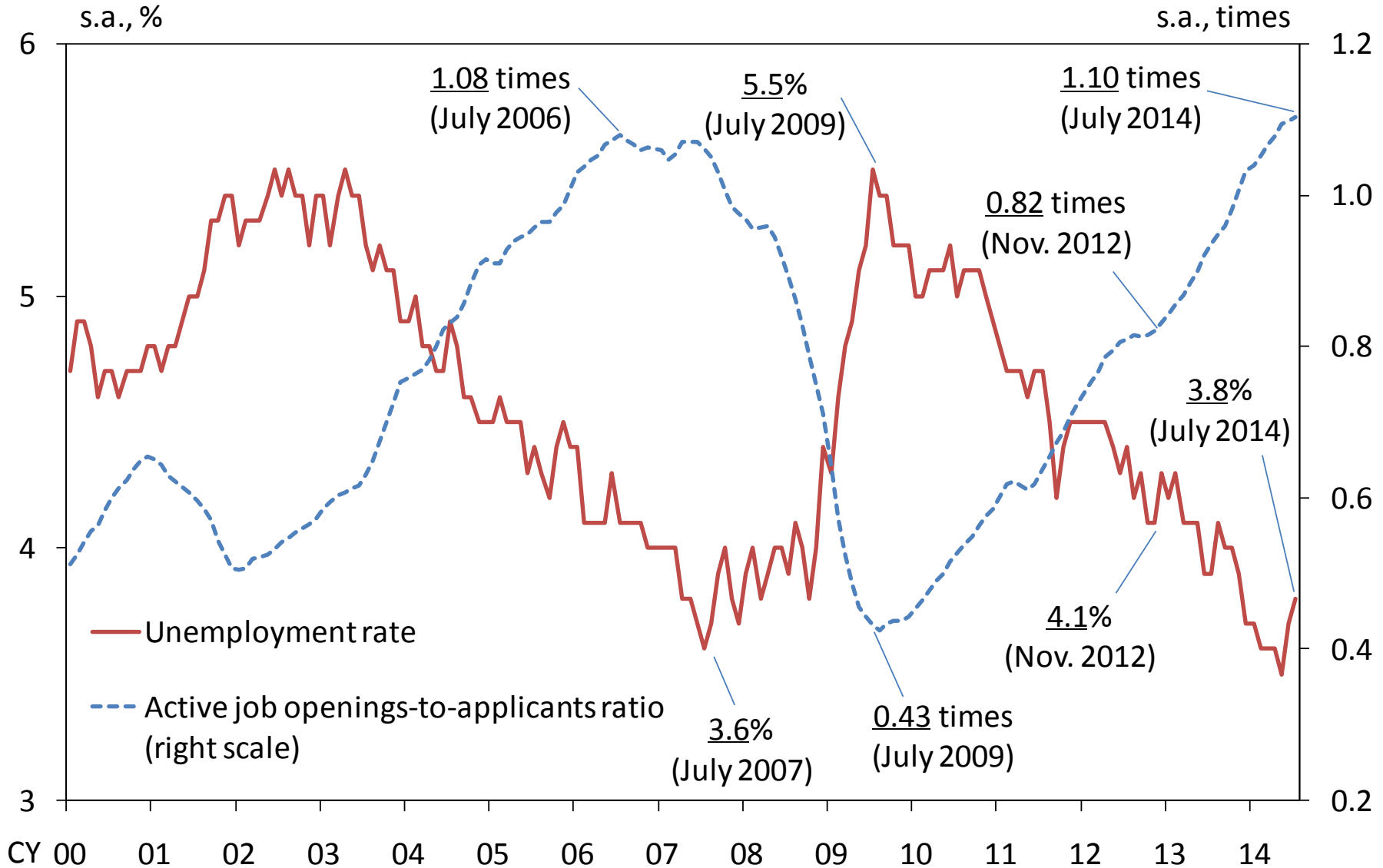
s.a., q/q % chg.

	2013				2014	
	Q1	Q2	Q3	Q4	Q1	Q2
Real GDP	1.2	0.8	0.4	▲0.1	1.5	▲1.8
<Annual rate>	<5.1>	<3.4>	<1.8>	<▲0.5>	<6.0>	<▲7.1>
Private Consumption	1.0	0.7	0.2	0.4	2.0	▲5.1
Residential Investment	0.8	2.1	4.7	2.4	2.0	▲10.4
Non-Resi. Investment	▲2.0	1.8	0.5	1.0	7.8	▲5.1
Government Consumption	0.9	0.6	0.1	0.2	▲0.2	0.1
Public Investment	4.7	5.8	7.1	1.4	▲2.5	▲0.5
Exports	4.3	3.1	▲0.7	0.3	6.5	▲0.5
Imports	1.2	2.3	1.8	3.7	6.4	▲5.6

Source: Cabinet Office, "National Accounts."

Chart 2

Labor Supply and Demand



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

Chart 3

Employee Income

y/y % chg.

	2013				2014		
	Q1	Q2	Q3	Q4	Q1	Q2	July
Total Cash Earnings (W)	▲0.6	0.3	▲0.4	0.4	0.1	0.8	2.6
Scheduled Cash Earnings	▲0.7	▲0.4	▲0.7	▲0.7	▲0.4	▲0.1	0.7
Non-Scheduled Cash Earnings	▲1.9	0.6	3.0	5.5	5.0	4.4	3.3
Special Cash Earnings	9.6	2.4	0.3	1.9	0.8	2.8	7.1
Number of Regular Employees (L)	0.5	0.7	0.9	1.1	1.2	1.4	1.6
Employee Income (W × L)	▲0.0	0.9	0.5	1.5	1.3	2.2	4.2

Source: Ministry of Health, Labour and Welfare, "Monthly Labour Survey."

Chart 4

Business Fixed Investment

▽ Private Non-Residential Investment

s.a., q/q % chg.

2013				2014	
Q1	Q2	Q3	Q4	Q1	Q2
▲2.0	1.8	0.5	1.0	7.8	▲5.1

Source: Cabinet Office, "National Accounts."

▽ Survey on Business Fixed Investment (*Tankan*)

y/y % chg.

	FY 2013 (Actual)		FY 2014 (Forecast)	
	March 2014	June 2014	March 2014	June 2014
All Industries	5.2	5.6	▲4.2	1.7
Manufacturing	3.1	0.5	1.2	10.1
Nonmanufacturing	6.3	8.2	▲6.9	▲2.4

Note: Figures include land purchasing expenses but exclude software investment. Figures are based on the new lease accounting standard.

Source: Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan."

▽ Survey on Business Fixed Investment (Development Bank of Japan)

y/y % chg.

	FY 2012 (Actual)	FY 2013 (Actual)	FY 2014 (Forecast)
All Industries	2.9	3.0	15.1
Manufacturing	2.7	▲1.7	18.5
Nonmanufacturing	3.1	5.4	13.2

Note: The survey covers private firms capitalized at ¥1 billion or more, excluding agriculture, forestry, finance, and insurance.

Source: Development Bank of Japan, "Survey on Planned Capital Spending."

Chart 5

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>+1.0</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>

Note: Figures indicate the median of the Policy Board members' forecasts (point estimates) as of July 2014.

Chart 6

World Economy

y/y % chg.

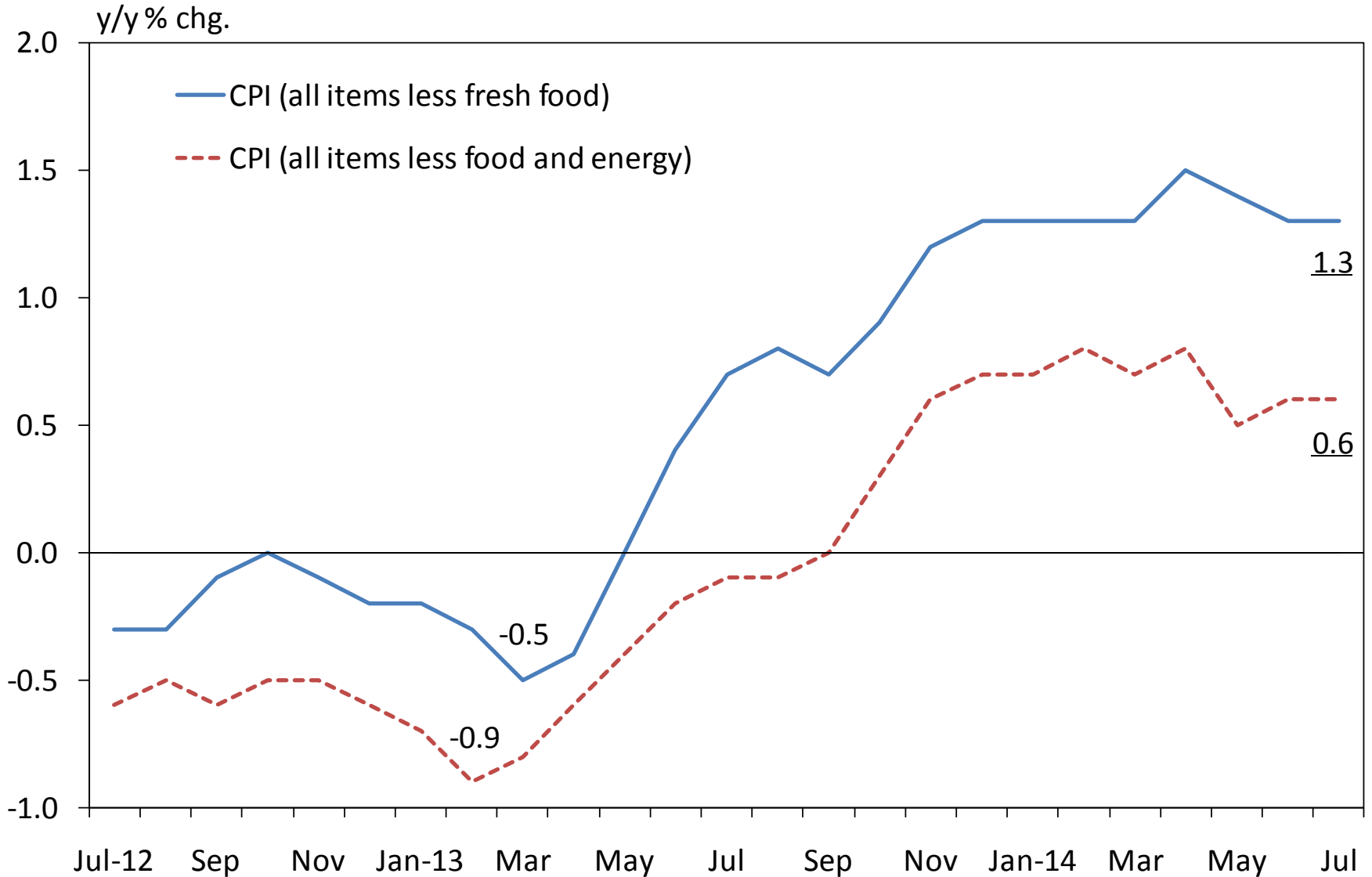
	2012	2013	2014 [Projections]	2015 [Projections]
World	3.5	3.2	3.4	4.0
Advanced Economies	1.4	1.3	1.8	2.4
United States	2.8	1.9	1.7	3.0
Euro Area	-0.7	-0.4	1.1	1.5
Japan	1.4	1.5	1.6	1.1
Emerging Market and Developing Economies	5.1	4.7	4.6	5.2
Developing Asia	6.7	6.6	6.4	6.7
China	7.7	7.7	7.4	7.1
ASEAN	6.2	5.2	4.6	5.6
Latin America and the Caribbean	2.9	2.6	2.0	2.6

Note: Figures are projections by the IMF as of July 2014.

Source: IMF, "World Economic Outlook."

Chart 7

Consumer Prices

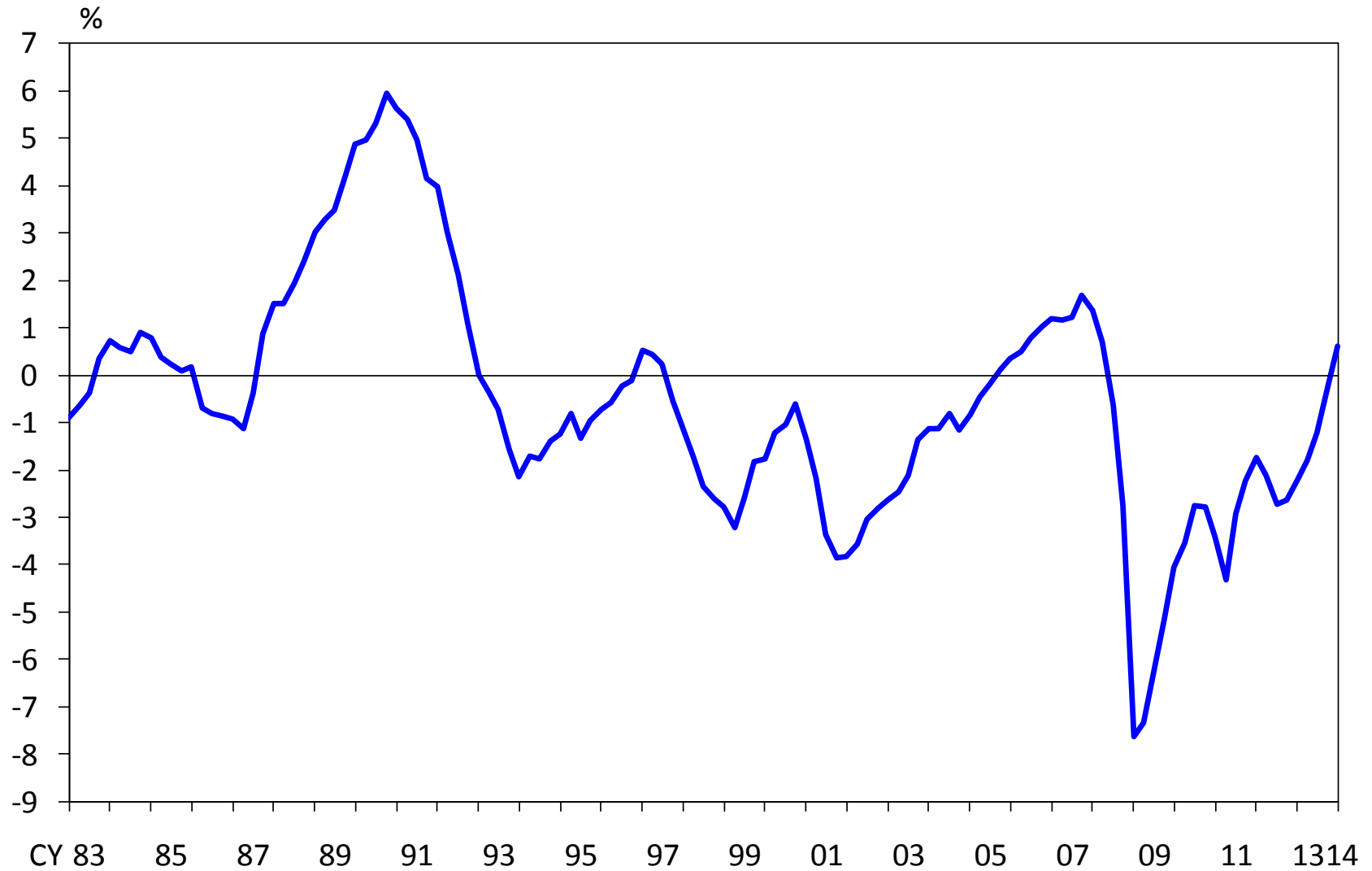


Note: Figures from April 2014 onward are calculated to adjust the direct effects of the consumption tax hike.

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

Chart 8

Output Gap



Note: The output gap is estimated by the Research and Statistics Department, Bank of Japan. For the estimation procedures, see "The New Estimates of Output Gap and Potential Growth Rate," Bank of Japan Review Series, 2006-E-3.

Sources: Cabinet Office, "National Accounts," etc.

Two Pillars of 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 the monetary base* at an annual pace of about ¥60-70 trillion (particularly through purchases of JGBs)

• **Change in Quality**

Purchases of riskier assets (JGBs with longer remaining maturities, ETFs and J-REITs)

* Money supplied directly from the central bank to the financial system.

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 QQE

Chart 11

Transmission Channels of QQE

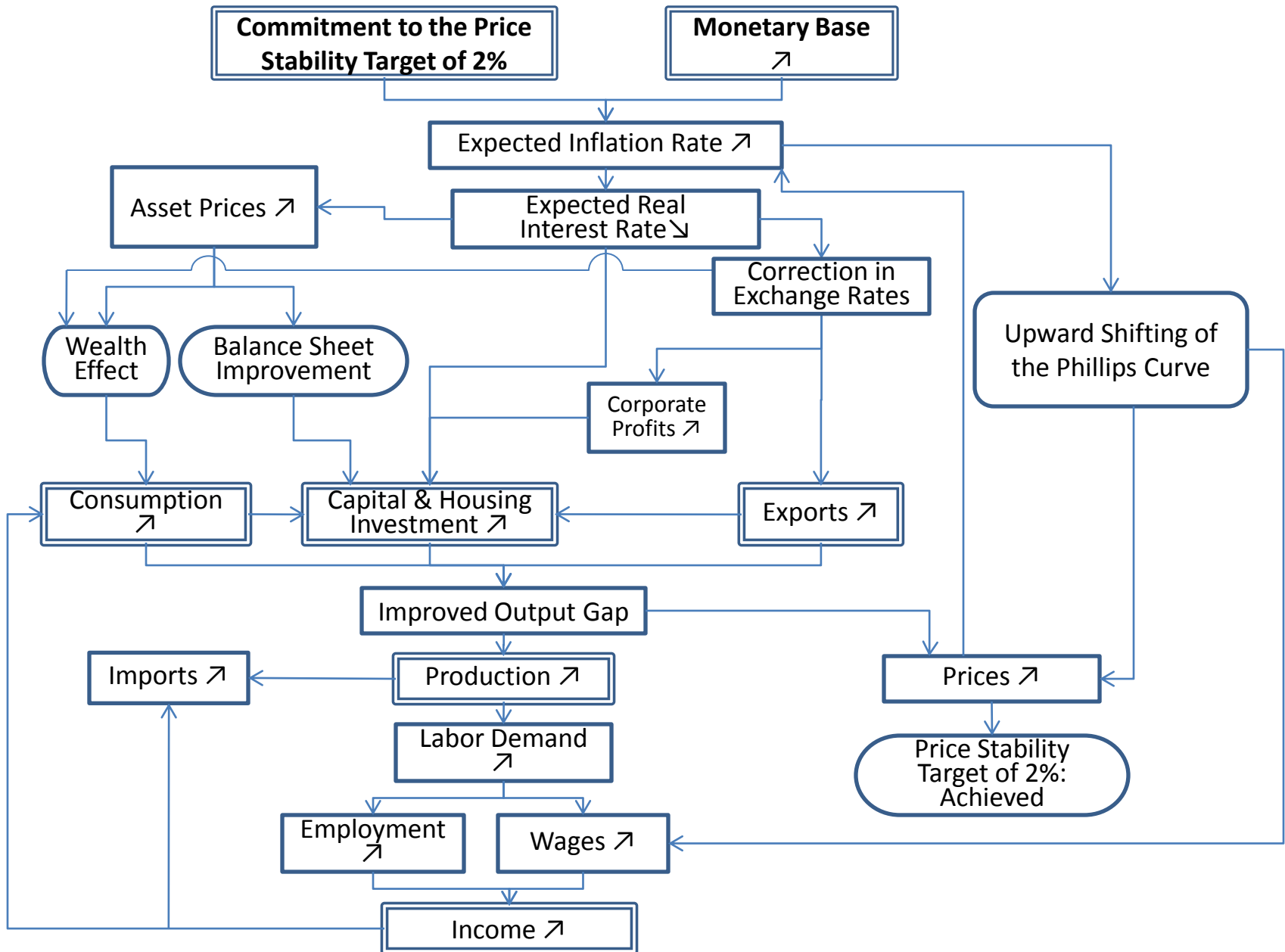
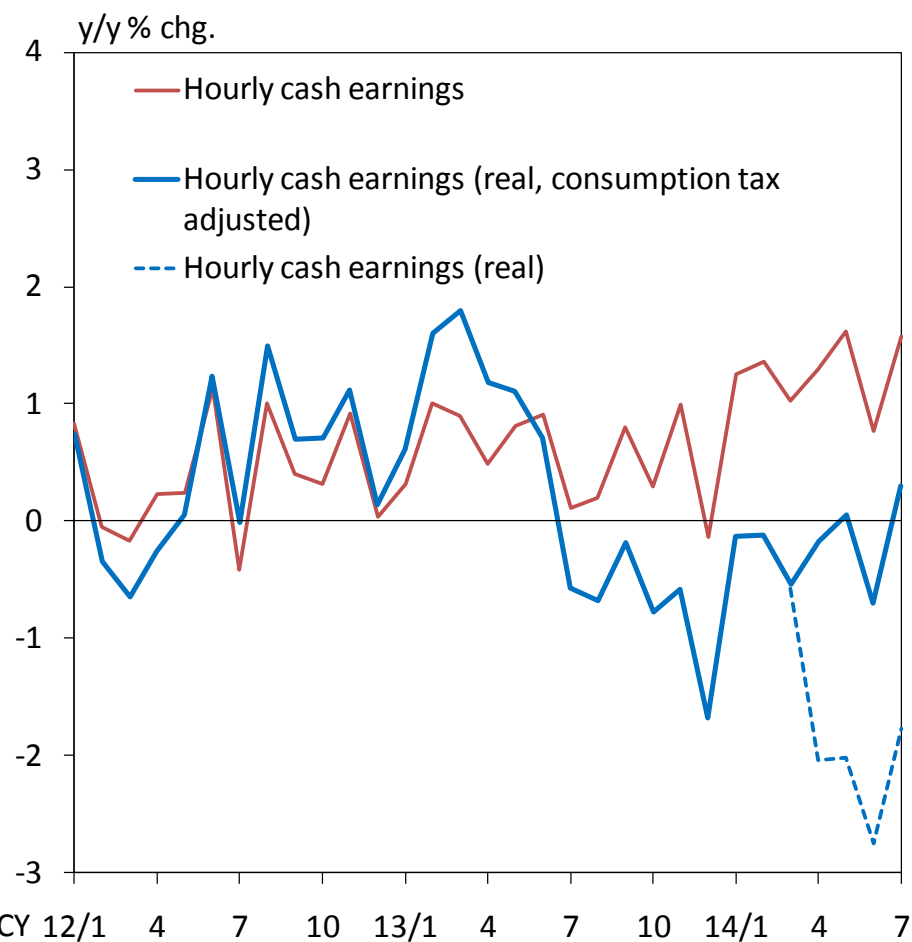
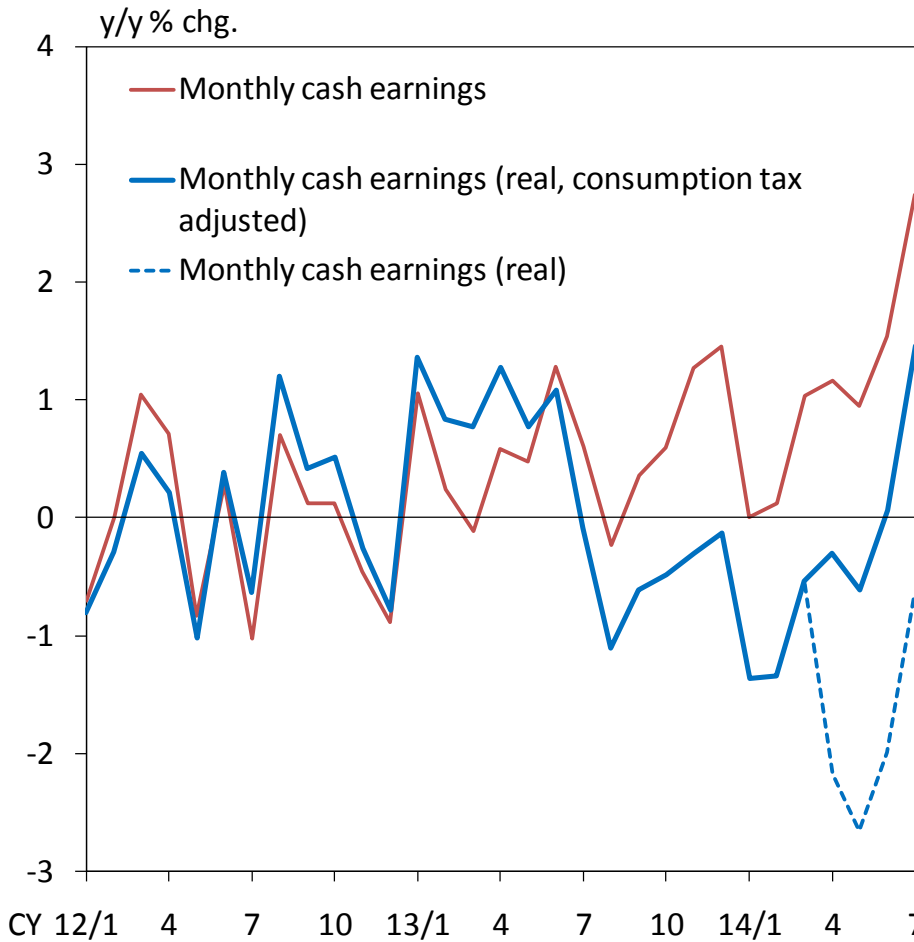


Chart 12

Real Wages

▽ Full-Time Employees

▽ Part-Time Employees



Note: Figures for real wages are nominal wages deflated by the CPI (all items). Those after adjusting consumption tax are nominal wages deflated by the CPI (all items), which was calculated to adjust the direct effects of the consumption tax hike.

Sources: Ministry of Health, Labour and Welfare, "Monthly Labour Survey"; Ministry of Internal Affairs and Communications, "Consumer Price Index."

Chart 13

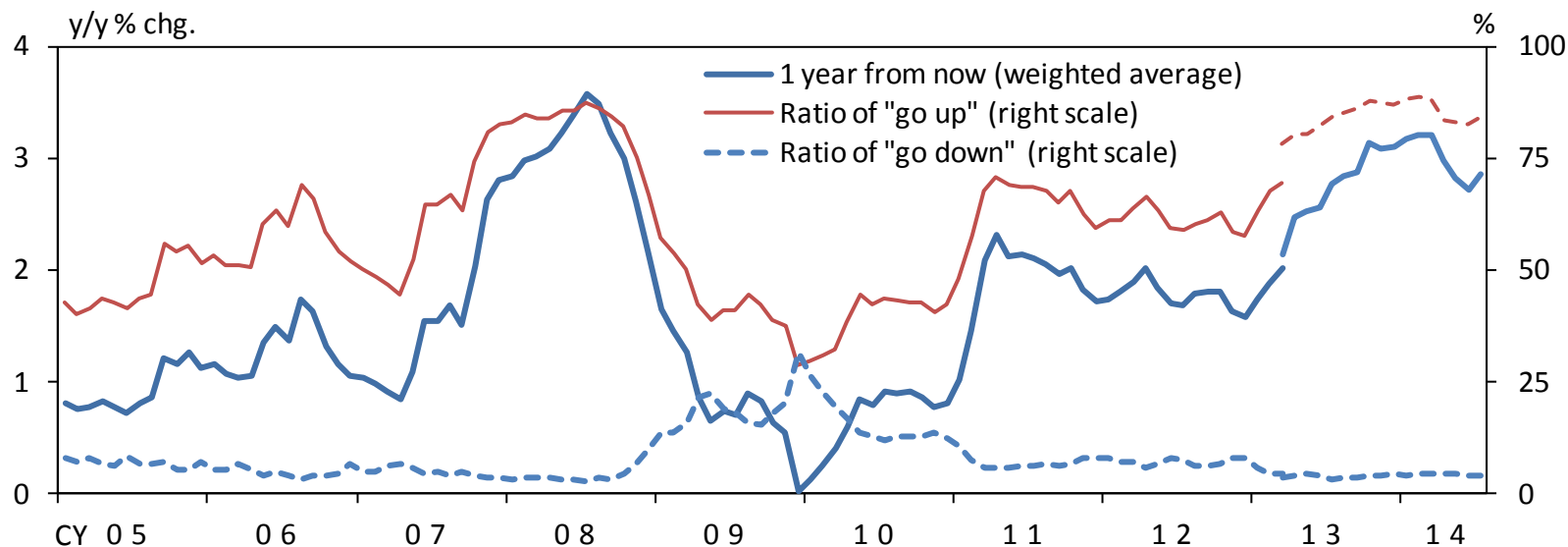
Inflation Expectations (1)

▽ Enterprises (*Tankan*)

y/y % chg. (All Industries, Average)

	1 year ahead			3 years ahead			5 years ahead		
	All Enterprises	Large Enterprises	Small Enterprises	All Enterprises	Large Enterprises	Small Enterprises	All Enterprises	Large Enterprises	Small Enterprises
Mar. 2014	1.5	1.1	1.7	1.7	1.3	1.9	1.7	1.3	1.9
June 2014	1.5	1.1	1.7	1.6	1.2	1.8	1.7	1.2	1.9

▽ Households



Note: Figures are for all households. The weighted average is calculated based on the following assumption: survey responses chosen by households as their expected inflation rates -- "-5% or below," "from -5% to -2%," "from -2% to 0%," "from 0% to +2%," "from +2% to +5%," and "+5% or above" -- indicate inflation rates of -5%, -3.5%, -1%, +1%, +3.5%, and +5%, respectively.

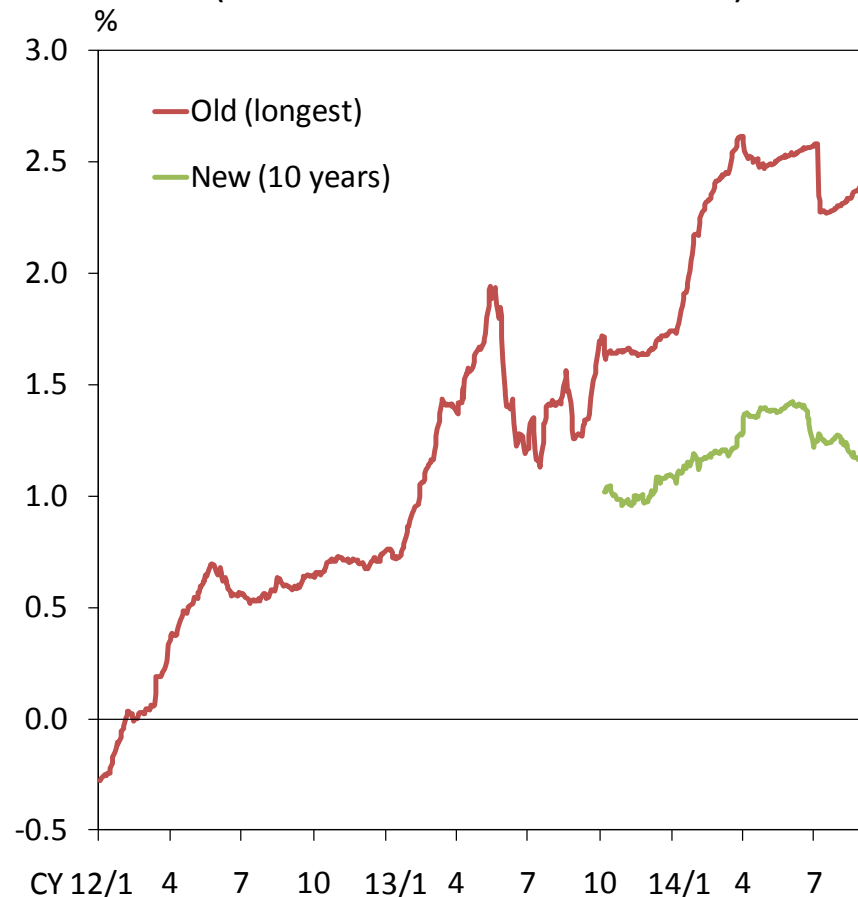
Sources: Bank of Japan, "*Tankan*, Short-Term Economic Survey of Enterprises in Japan"; Cabinet Office, "Consumer Confidence Survey."

Inflation Expectations (2)

▽ Economists (ESP Forecast)

	%		
	FY 2014	FY 2015	FY 2016
March 2014	2.95 <0.95>	1.68 <1.01>	—
April	2.97 <0.97>	1.69 <1.03>	—
May	2.99 <0.99>	1.70 <1.05>	—
June	3.08 <1.08>	1.78 <1.10>	2.00 <1.32>
July	3.12 <1.11>	1.79 <1.12>	2.01 <1.30>
August	3.15 <1.14>	1.82 <1.16>	2.00 <1.29>
September	3.17 <1.17>	1.82 <1.16>	1.94 <1.28>

▽ Market Participants
(BEI for Inflation-Indexed JGBs)



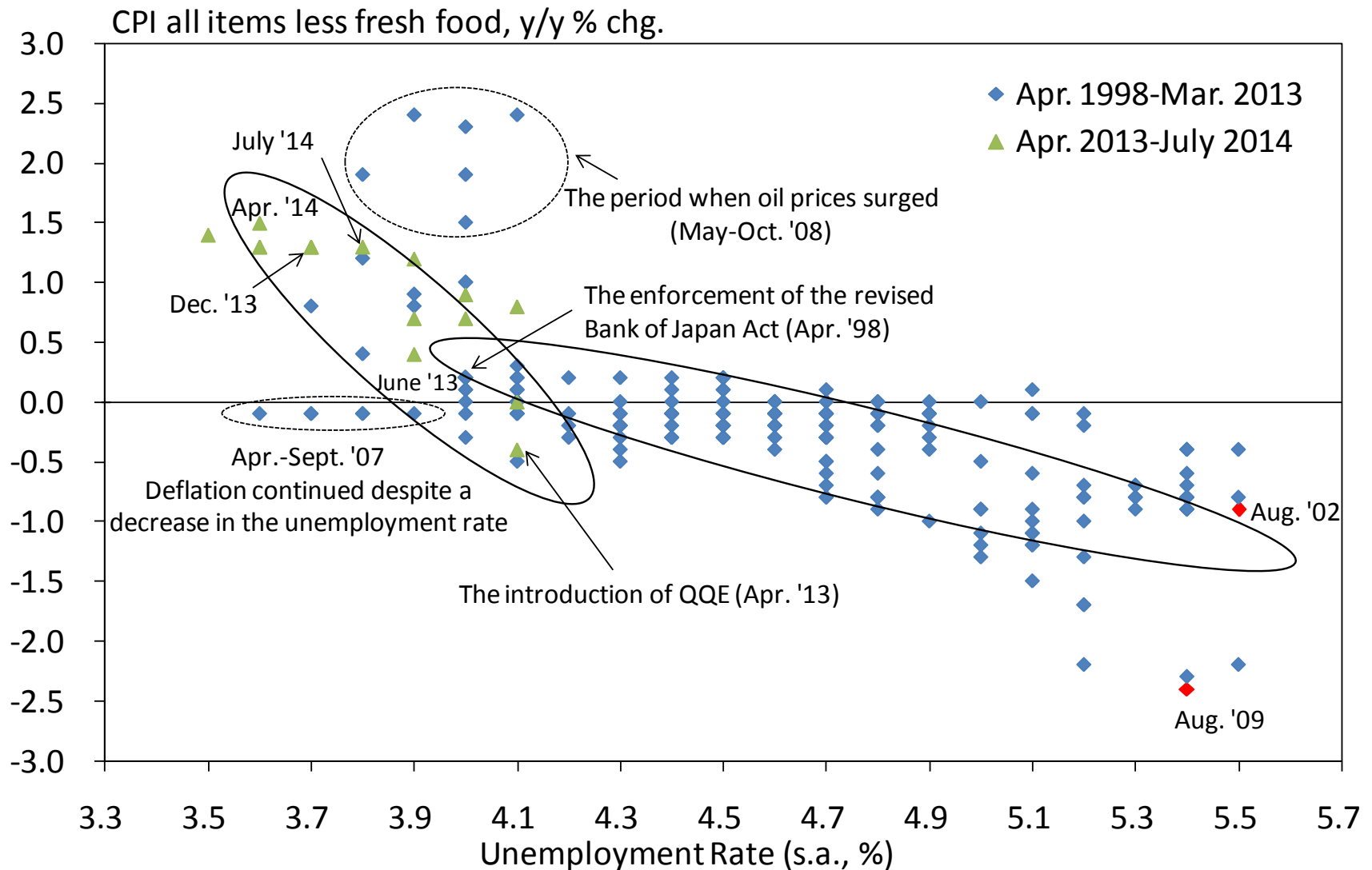
Notes: 1. Figures in angular brackets for the ESP Forecast exclude the effects of the consumption tax hikes.

2. BEI (break-even inflation) rates are 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 are designated 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.

Sources: JCER, "ESP Forecast"; Bloomberg.

Chart 15

Unemployment Rate and Inflation Rate



Note: Figures for the CPI from April 2014 onward are calculated to adjust the direct effects of the consumption tax hike.

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

Chart 16

U.S. Dollar/Yen Exchange Rate and Inflation Rate

— Prior to the introduction of QQE (Apr. 1998-Mar. 2013) —

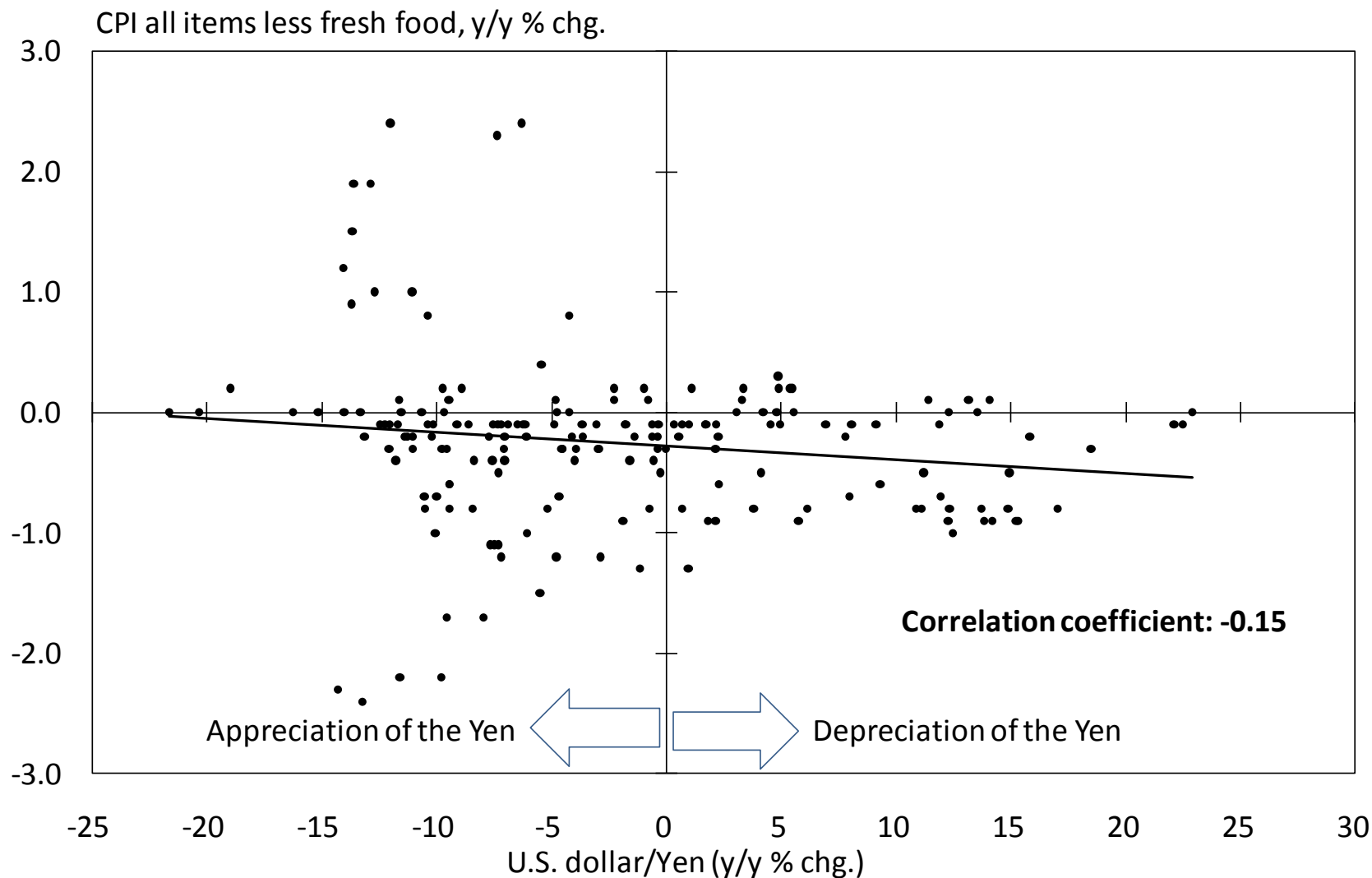
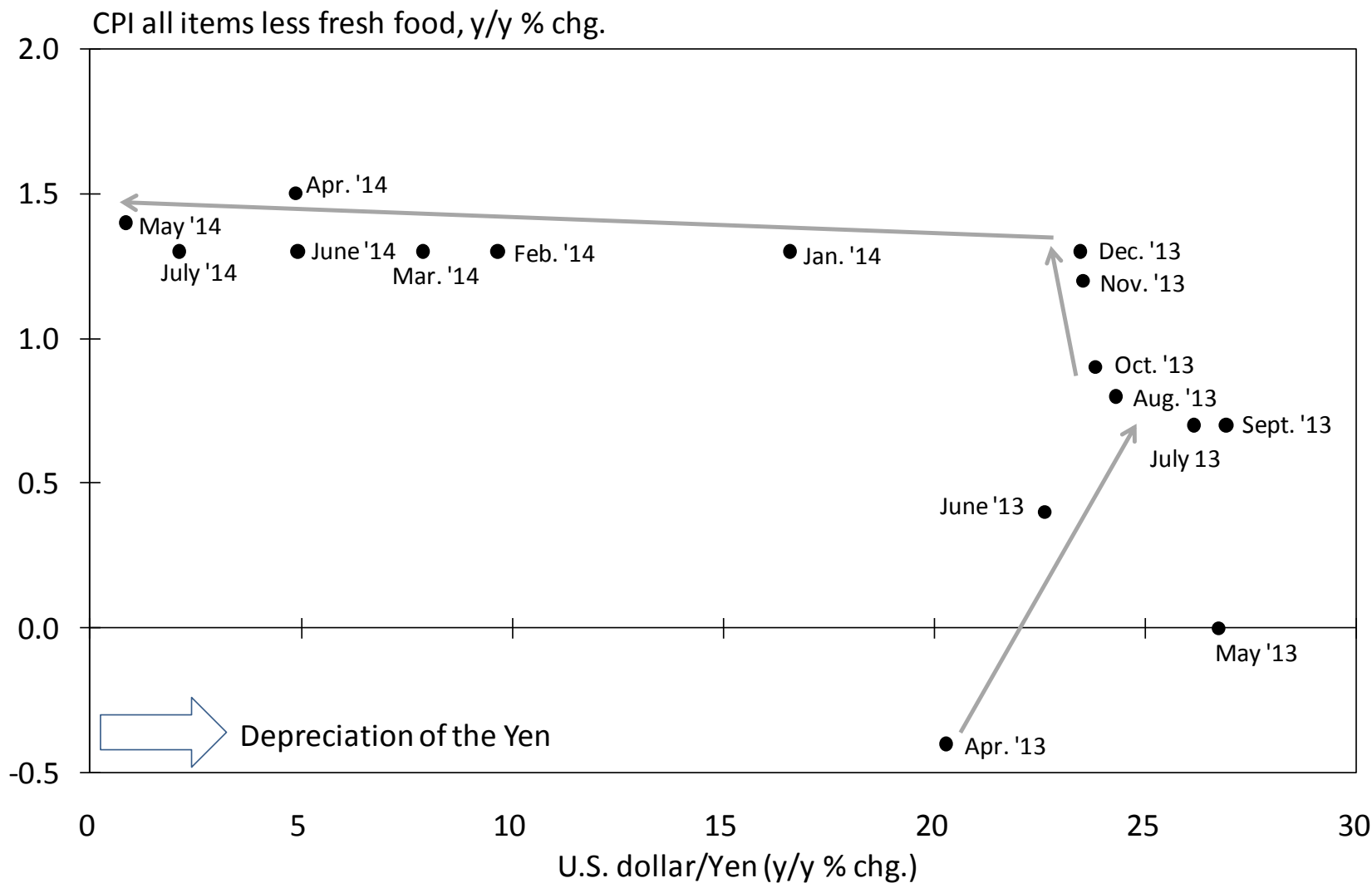


Chart 17

U.S. Dollar/Yen Exchange Rate and Inflation Rate

— After the introduction of QQE (Apr. 2013-July 2014) —



Note: Figures for the CPI from April 2014 onward are calculated to adjust the direct effects of the consumption tax hike.

Sources: Ministry of Internal Affairs and Communications, "Consumer Price Index"; Bloomberg.