



August 31, 2017  
Bank of Japan

---

**Economic Activity, Prices,  
and Monetary Policy in Japan**

*Speech at a Meeting with Business Leaders in Ehime*

**Takako Masai**

*Member of the Policy Board*

(English translation based on the Japanese original)

## **I. Developments in Economic Activity and Prices**

I would like to start my speech with a look at developments in economic activity and prices.

At the Monetary Policy Meeting held on July 19 and 20, 2017, the Bank of Japan published the *Outlook for Economic Activity and Prices*, or the Outlook Report. In this report, the Bank presented its projections for Japan's economic activity and prices through fiscal 2019.

I will explain developments in economic activity and prices by presenting the main content of the Outlook Report.

### **A. Overseas Economies**

Let me first touch on developments in overseas economies. The Bank's assessment is that overseas economies have continued to grow at a moderate pace on the whole.

In terms of the outlook, advanced economies are projected to continue growing steadily and a recovery in emerging economies is likely to take hold on the back of the steady growth in advanced economies and the effects of policy measures taken by emerging economies. A similar view was presented in the *World Economic Outlook (WEO) Update* released in July 2017 by the International Monetary Fund (IMF).

Looking at developments by major region, the U.S. economy has continued to recover, mainly in household spending, owing to a steady improvement in the employment and income situation. As for the outlook, the economy is expected to continue to see firm growth driven by domestic private demand.

The European economy will likely follow a moderate recovery trend, while uncertainty -- associated with political issues such as those regarding negotiations on the United Kingdom's exit from the European Union (EU) and with the European debt problem, including the financial sector -- is likely to be a burden on economic activity.

The Chinese economy will likely continue to broadly follow a stable growth path as authorities conduct fiscal and monetary policy in a timely manner.

Other emerging economies and commodity-exporting economies have picked up on the whole, reflecting in particular a pick-up in exports, a bottoming out of commodity prices, and the effects of these economies' stimulus measures. These economies are likely to increase gradually, due mainly to the spread of the effects of steady growth in advanced economies.

## **B. Japan's Economy and Price Developments**

### 1. Current situation

Now I would like to discuss developments in economic activity and prices in Japan.

The Bank's assessment is that Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. In fiscal 2017 to date, the Bank has revised its economic assessment upward twice. These revisions are based on its judgment that a positive output gap has taken hold, as evidenced by the fact that industrial production has been on an increasing trend, reflecting the increases in demand both at home and abroad, and that labor market conditions have continued to tighten steadily.

On the domestic demand side, business fixed investment has been on a moderate increasing trend, with corporate profits and business sentiment improving and across a wider range of industries. According to the June 2017 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), business plans for fiscal 2017, especially those of large enterprises, showed firms' solid stance. This is evidenced by, for example, the fact that fixed investment on a basis close to GDP definition saw a year-on-year increase of 5.9 percent -- a level clearly exceeding the past average of 4.3 percent for the June *Tankan* surveys during the period of fiscal 2004-2016. Private consumption has increased its resilience against the background of steady improvement in the employment and income situation, and housing investment has been more or less flat. Exports have been on an increasing trend against the backdrop of developments in overseas economies that I mentioned earlier.

On the price front, the year-on-year rate of change in the consumer price index (CPI) for all items less fresh food is in the range of 0.0-0.5 percent.

## 2. Outlook

I will now look at the outlook for Japan's economy during the projection period, which covers from fiscal 2017 through fiscal 2019. The economy is likely to continue its moderate expansion. Domestic demand is likely to follow an uptrend on the back of highly accommodative financial conditions and fiscal spending through the government's large-scale stimulus measures. Exports are expected to continue their moderate increasing trend along with the improvement in overseas economies. Reflecting this outlook, Japan's economy is likely to maintain growth at a pace above its potential mainly through fiscal 2018. In fiscal 2019, it is expected to continue expanding, although the growth pace is projected to decelerate due to a cyclical slowdown in business fixed investment and the effects of the scheduled consumption tax hike. Looking at the medians of the Policy Board members' forecasts in the July 2017 Outlook Report, the real GDP growth rate is projected to be 1.8 percent for fiscal 2017, 1.4 percent for fiscal 2018, and 0.7 percent for fiscal 2019.

Let me explain the outlook in detail by major component. Business fixed investment is likely to continue increasing moderately. This is because, in a situation where extremely stimulative financial conditions are maintained, fixed investment will be positively affected by (1) high levels of corporate profits, (2) fiscal measures including projects conducted under the Fiscal Investment and Loan Program and tax reductions for capital investment, and (3) moderate improvement in growth expectations. Specifically, an increase is likely to be seen in investment, particularly (1) that related to the Olympic Games and urban redevelopment projects, (2) in efficiency-improving and labor-saving machinery and equipment in order to deal with labor shortages, and (3) in research and development for growth areas. Private consumption is expected to continue increasing moderately as the employment and income situation continues to improve, and housing investment is expected to remain more or less flat. Exports are likely to be firm as a trend for the time being, underpinned by those of capital goods and IT-related goods -- in which Japan has a comparative advantage. Thereafter, they are expected to continue their moderate increasing trend, due mainly to the improvement in overseas economies, albeit with a decline in IT-related demand following the current increase. Industrial production is projected to continue on a moderate increasing trend -- despite being affected by the cycle of global

demand for IT-related goods -- as the recovery in emerging economies takes hold and the effects of the set of stimulus measures become evident.

The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase toward around 2 percent. This is because, although upward pressure of energy prices is likely to wane gradually, firms are likely to gradually shift their stance toward raising wages and prices with an improvement in the output gap, and inflation expectations are expected to accelerate moderately. Looking at the medians of the Policy Board members' forecasts in the July 2017 Outlook Report, the year-on-year rate of change in the CPI (all items less fresh food) is projected to be 1.1 percent for fiscal 2017, 1.5 percent for fiscal 2018, and -- on a basis excluding the effects of the scheduled consumption tax hike -- 1.8 percent for fiscal 2019.

## **II. The Bank's Monetary Policy**

Next, I will talk about the Bank's monetary policy.

### **A. Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control**

At the Monetary Policy Meeting held in September 2016, with a view to achieving the price stability target of 2 percent at the earliest possible time, the Bank decided to introduce QQE with Yield Curve Control as a means of strengthening the framework for monetary easing. This consists of two major components.

The first is an "inflation-overshooting commitment" in which the Bank commits itself to continuing to expand the monetary base until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner. Japan's economy has suffered from deflation for more than 15 years, since the late 1990s, with the year-on-year rate of change in the CPI being about zero or slightly negative. It seems that one of the reasons why it has been taking time for the deflationary mindset to be dispelled in Japan is that households and firms have been adaptive to the deflationary environment. Given this, I believe it is important that the Bank demonstrate its unwavering determination through such a commitment so that the perception that prices of

goods and services are supposed to go up every year by around 2 percent becomes firmly entrenched among people.

The second component is "yield curve control" in which the Bank controls short-term and long-term interest rates. In the current framework, it sets the short-term policy interest rate and the target level of the 10-year Japanese government bond (JGB) yields as its operating targets. At present, in the guideline for market operations, the Bank sets the short-term rate at minus 0.1 percent and the target level at around 0 percent, and conducts JGB purchases so as to achieve this target level. Almost a year has passed since the Bank introduced QQE with Yield Curve Control. Under this framework, the yield curve has been formed smoothly so far in a manner consistent with the guideline for market operations.

Since the introduction of QQE in 2013, the basic transmission channel of monetary easing has been the reduction in real interest rates, and the current framework -- QQE with Yield Curve Control -- is designed to amplify monetary easing effects when the outlook for economic activity and prices improves. In that case, there would be upward pressure on interest rates in accordance with such improvement. The degree of monetary easing will increase if the Bank contains such upward pressure and thereby maintains the shape of the yield curve.

## **B. Toward Achieving the Price Stability Target**

The Bank projects that the timing of the year-on-year rate of change in the CPI reaching about 2 percent will be around fiscal 2019. In the Outlook Report, the Bank has delayed such timing several times, and I acknowledge that there is some criticism on this point. The Bank certainly aims to achieve the price stability target of 2 percent at the earliest possible time, and the delay in such timing is not desirable. However, what I believe is important for the Bank is -- in the event that the 2 percent price stability target cannot be achieved due to economic and price developments at the time -- to thoroughly explain the reasons behind the target not being achieved and to implement monetary policy so that the economy will follow a path toward the target. After all, it is well known that the policy framework of inflation targeting is expected to perform the role of a communication tool.

As I mentioned earlier, the year-on-year rate of change in the CPI is in the range of 0.0-0.5 percent, meaning that there is still a long way to go to achieve the price stability target of 2 percent. Nevertheless, my view is that the momentum toward achieving the target has started to steadily increase. In this regard, let me highlight two points.

First, although it has been said that wages have not been increasing as expected, scheduled cash earnings have continued to rise for more than two years. Let me also note that, as scheduled cash earnings have been rising steadily at small firms, where the majority of workers are employed, a clearly increasing number of households can now feel that their wages actually have been rising. This is highly important in terms of raising people's inflation expectations.

The second point is that there clearly has been a growing impetus toward raising productivity, due in part to labor shortages. As I noted earlier, investment that serves a positive purpose -- such as that in efficiency-improving and labor-saving machinery and equipment, and in research and development for growth areas -- is expected to further rise, and this will likely contribute to improving productivity. Moreover, it has become easier for firms to take advantage of such new information technologies as artificial intelligence (AI) and the Internet of Things (IoT). Let me also mention that the government's latest growth strategy, the Investments for the Future Strategy 2017 -- which was decided by the Cabinet in June 2017 -- emphasizes the importance of promoting comprehensive policies with the aim of improving productivity in the economic society. In addition to such policy measures being steadily pursued by the government, the Bank's initiatives to maintain highly accommodative financial conditions and ensure the overcoming of deflation will continue to foster positive developments among firms. In my view, this will lead to improvement in productivity and ultimately to a rise in the potential growth rate.

The initiatives of the public and private sectors, such as those just mentioned, have been carried out in a remarkably wide range of fields. The promotion of women's participation in the economy -- the next topic I will touch upon -- is one example.

### **III. Women's Participation in the Economy and Increase in Japan's Growth Potential**

In April 2016, the Act on Promotion of Women's Participation and Advancement in the Workplace was fully enforced. Since then, it has become a mandate for business entities to formulate and make public their action plans that incorporate numerical goals toward promoting women's participation in the workplace, and to disclose information on women's job choices. While the Act has been enacted as a temporary legislation with a 10-year term limit, it aims at actively providing women with opportunities for employment and promotion. In that sense, it clearly differs from past ones for which the key element was a ban on gender discrimination. Let me note that business entities that are mandated to disclose information in accordance with the Act include government agencies, local governments, and large private-sector corporations. The Bank also has disclosed information in accordance with the Act, and in May 2017, it gained the highest level of the "Eruboshi" award -- a certification from the Ministry of Health, Labour, and Welfare for excellent implementation of initiatives toward promoting women's participation and advancement in the workplace.

With the full enforcement of the Act, Japan has entered a new stage of women's participation in the economy. Such participation is placed at the center of the government's Japan Revitalization Strategy, and is essential in terms of increasing the growth potential.

#### **A. Women's Participation Expected to Increase Labor Supply**

The labor force participation rate of women by age group in Japan has been known to form an M-shaped curve, where the rate temporarily dips for the age group in which many women experience childbirth and provide childcare. Recently, however, women in this age group seem to be increasingly participating in the labor force, and the temporary dip in the rate clearly has moderated. Looking at the breakdown of the number of workers by gender over the past five years, that for women has been increasing -- despite the decline in the overall working-age population -- and therefore it can be assessed that women's participation in the labor force has been progressing smoothly. Furthermore, such developments have been spreading across Japan. I should note that the estimated number of women who wish to work still stands at about 2.74 million, which shows that women continue to constitute a considerably large potential labor force. Japan's economy currently



faces severe labor shortages, and a worsening of this situation is inevitable amid the further decline in the working-age population. The Organisation for Economic Co-operation and Development (OECD) estimates that, if women's labor participation rate in Japan were to remain the same over the next 20 years, the labor supply would contract by 17 percent; meanwhile, if women's participation rate were to converge with that of men over the next 20 years, the fall in labor supply would be limited to 5 percent. As a result, GDP would increase by almost 20 percent over the two decades.<sup>1</sup>

## **B. Expectations for Improving Firms' Competitiveness**

In addition to the impact on labor supply of women's participation in the workplace, improving firms' competitiveness through the promotion of such participation will become more important. In the annex to the *Regional Economic Report* released in June 2017, the Bank introduced some recent initiatives taken by firms to raise productivity through the following two innovations associated with the promotion of women's participation in the workplace.<sup>2</sup>

First was an initiative -- through product innovation -- that created potential demand by making use of women's viewpoint and sensibility in developing and providing new products and services. The annex presented examples of a case in which firms succeeded in discovering demand that led to boosting their corporate performance, such as the following: a hotel that had commonly been used for business trips conducted a renovation of guest rooms and a renewal of amenity goods by adopting suggestions from women employees, and this led to acquiring female tourists. I think that having such a successful experience even once will enable firms to take a more positive stance toward going through the trials and errors of reforming their business models.

---

<sup>1</sup> The OECD estimates the effects of women's labor force participation rate on labor supply under the two scenarios based on the following assumptions: (1) the labor force participation rates for both men and women remain constant from 2011 to 2030 at the rates observed in 2010, and (2) the labor force participation rate for men stays the same from 2011 to 2030 at the rate observed in 2010 while that for women gradually increases from 2011 to 2030, reaching the 2010 rate for men by 2030. For details, see OECD (2014), *Japan: Advancing the Third Arrow for a Resilient Economy and Inclusive Growth*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264215955-en>.

<sup>2</sup> The annex to the *Regional Economic Report* is available only in Japanese.

Second was an initiative -- through process innovation -- that consequently led to improvement in business efficiency as a result of measures implemented in the process of promoting women's participation in the workplace, such as redressing of long working hours and labor-saving investment. It may seem that redressing of long working hours spurs labor shortages. However, the annex in fact presented an example of efforts made by firms in which they eliminated tasks that fell short of being necessary, as a result of the fact that working hours were forcibly shortened and there was no choice but to reduce the amount of work.

### **C. Opportunity to Increase the Economic Growth Potential**

I would like to highlight again that, at present, not only are firms facing the challenge of labor shortages, but they also have more opportunity to take advantage of such information technologies as AI and the IoT. In other words, there is an environment in which firms are encouraged to reform their business models. One option for firms at this time is to aim at starting a business revolution by using women's participation and advancement in the workplace as a driving force, as this momentum is increasing, due in part to the government's support that I mentioned earlier.