Japan's Economy and Monetary Policy

Speech at a Meeting with Business Leaders in Nagoya

November 5, 2018

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Introduction

I. Economic Developments

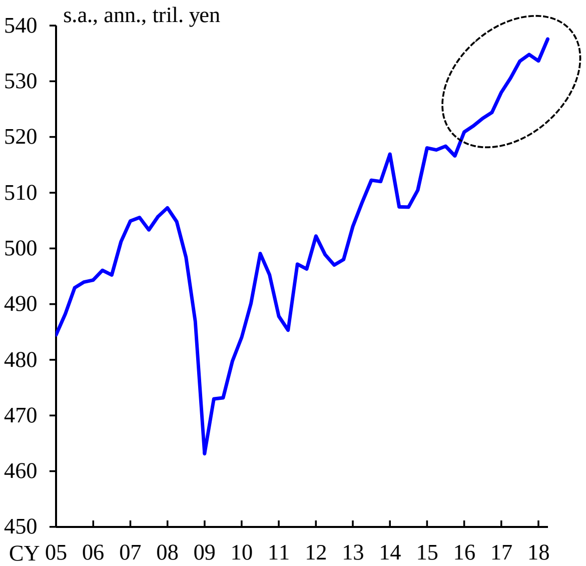
II. Price Developments

III. The Bank's Conduct of Monetary Policy

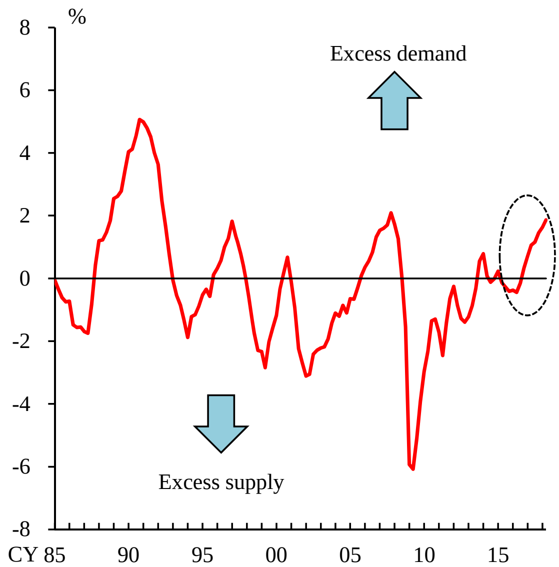
Conclusion

Japan's Economy

Real GDP



Output Gap



Note: The output gap is based on BOJ staff estimations.
Sources: Cabinet Office; Bank of Japan.

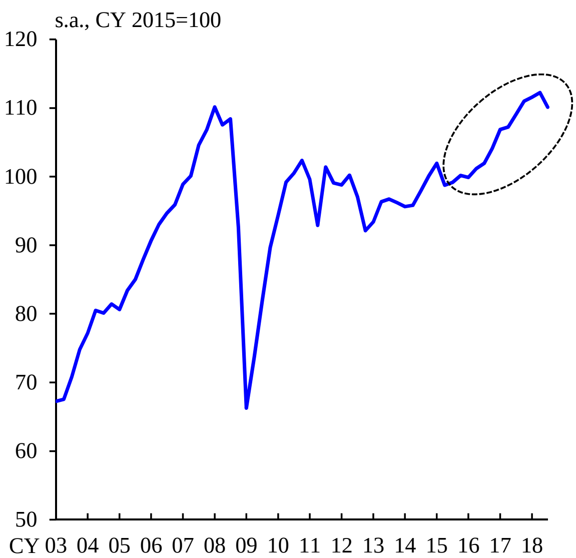
Overseas Economies and Exports

Projections for Major Economies (IMF)

y/y % chg., % points

	2016	2017	2018 Projection	2019 Projection
World	3.3	3.7	**3.7 (-0.2)**	**3.7 (-0.2)**
Advanced economies	1.7	2.3	2.4 (0.0)	2.1 (-0.1)
United States	1.6	2.2	2.9 (0.0)	2.5 (-0.2)
Euro area	1.9	2.4	2.0 (-0.2)	1.9 (0.0)
Japan	1.0	1.7	1.1 (0.1)	0.9 (0.0)
Emerging market and developing economies	4.4	4.7	4.7 (-0.2)	4.7 (-0.4)
China	6.7	6.9	6.6 (0.0)	6.2 (-0.2)
ASEAN-5	4.9	5.3	5.3 (0.0)	5.2 (-0.1)

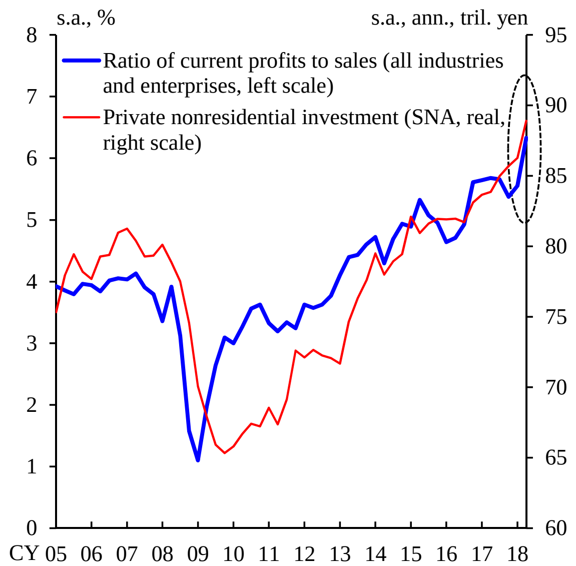
Real Exports



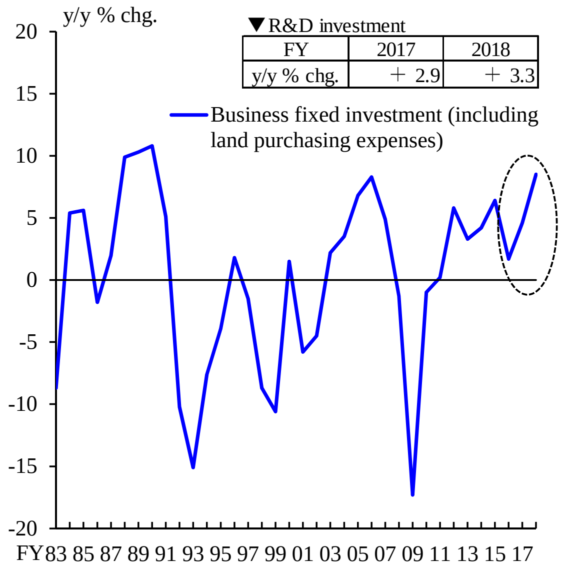
Note: The post-2018 figures in the left table are based on October 2018 WEO projections. Figures in parentheses show the differences from the July 2018 projections.
Sources: IMF; Ministry of Finance; Bank of Japan.

Corporate Profits and Business Fixed Investment

Corporate Profits



Business Fixed Investment Plans (September Tankan)



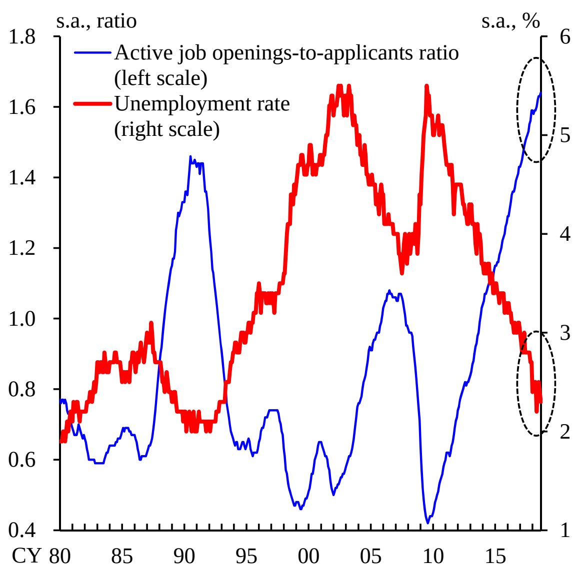
▼R&D investment

FY	2017	2018
y/y % chg.	＋ 2.9	＋ 3.3

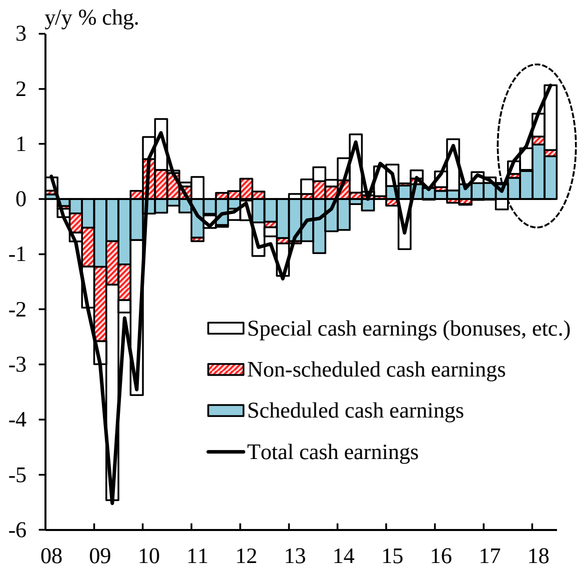
Notes: 1. Figures for ratio of current profits to sales are based on the *Financial Statements Statistics of Corporations by Industry, Quarterly* (from 2009/Q2 exclude "pure holding companies"). Excluding "finance and insurance."
2. Figures for business fixed investment (including land purchasing expenses) and R&D investment are based on the plans as of September *Tankan* in each fiscal year (all enterprises).
Sources: Ministry of Finance; Cabinet Office; Bank of Japan.

Employment and Income Situation

Labor Market Conditions



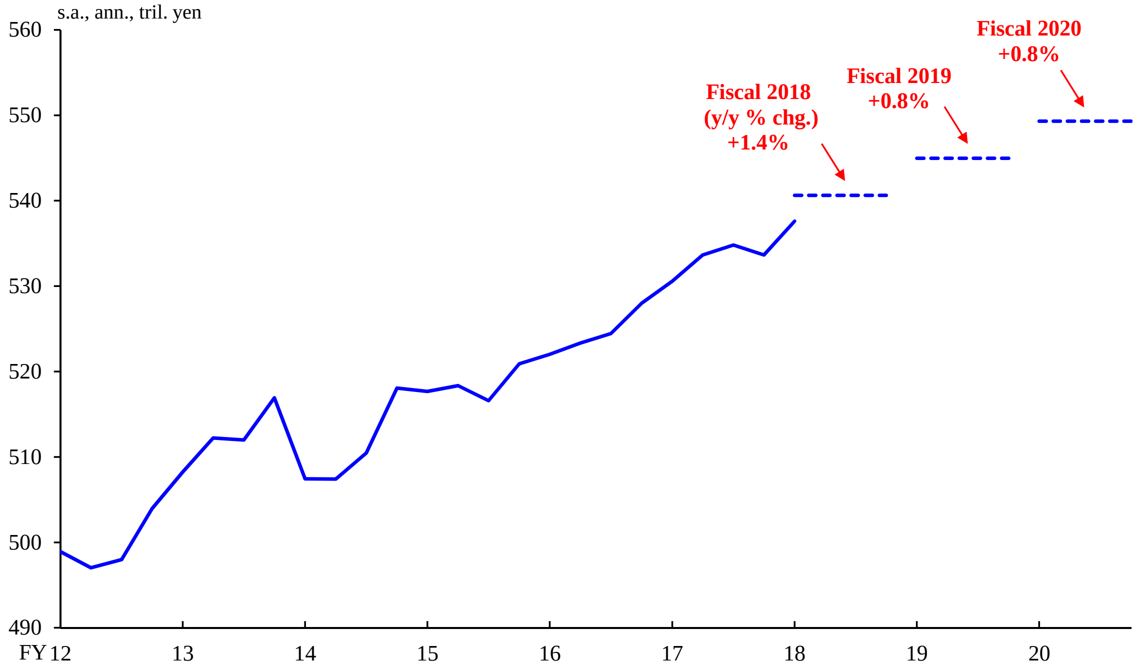
Nominal Wages



Note: In the right chart, Q1 = March-May, Q2 = June-August, Q3 = September-November, Q4 = December-February.
Sources: Ministry of Health, Labour and Welfare; Ministry of Internal Affairs and Communications.

BOJ's Forecasts of the Real GDP

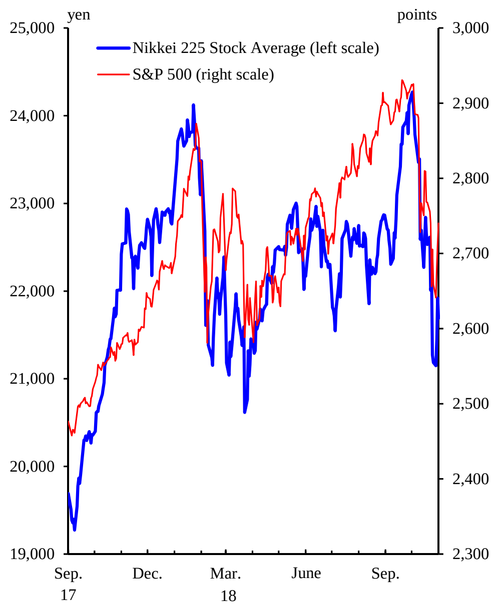
(October 2018 Outlook Report)



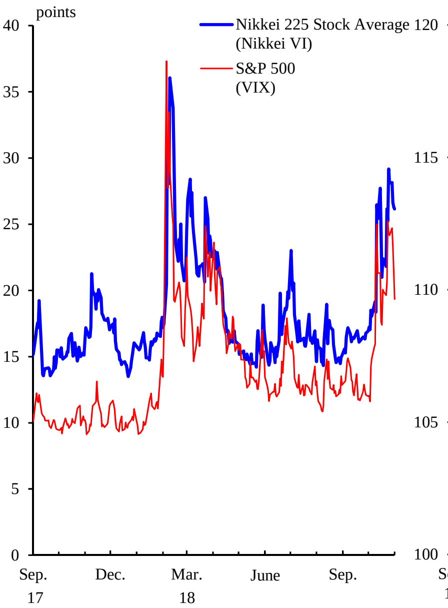
Note: Forecasts are the medians of the Policy Board members' forecasts (point estimates).
Sources: Cabinet Office; Bank of Japan.

Developments in Financial Markets

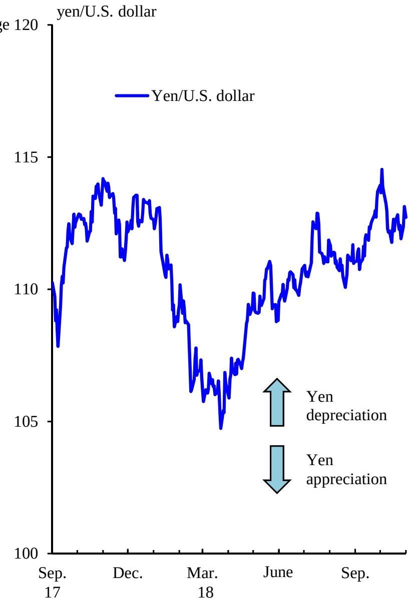
Stock Markets



Volatilities of Stock Prices

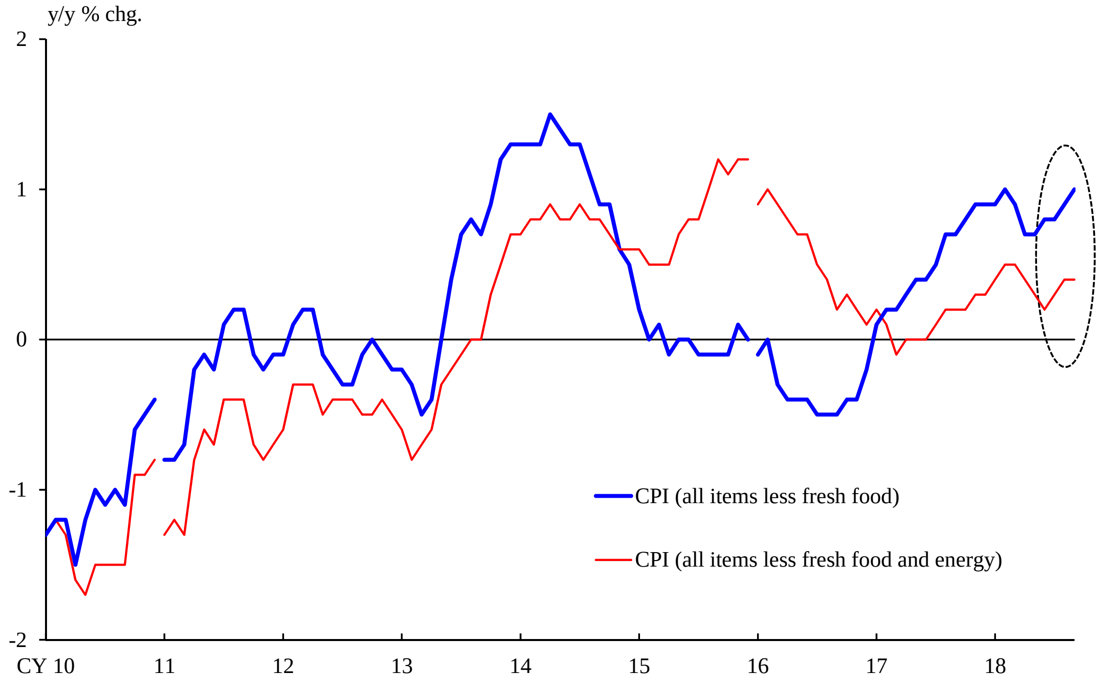


Foreign Exchange Markets



Source: Bloomberg.

Consumer Prices



Note: Figures are adjusted for changes in the consumption tax rate.
Source: Ministry of Internal Affairs and Communications.

Reasons for a Rise in Inflation Taking Time

Mindset

- ✓ Experience of prolonged low growth and deflation

Supply Side

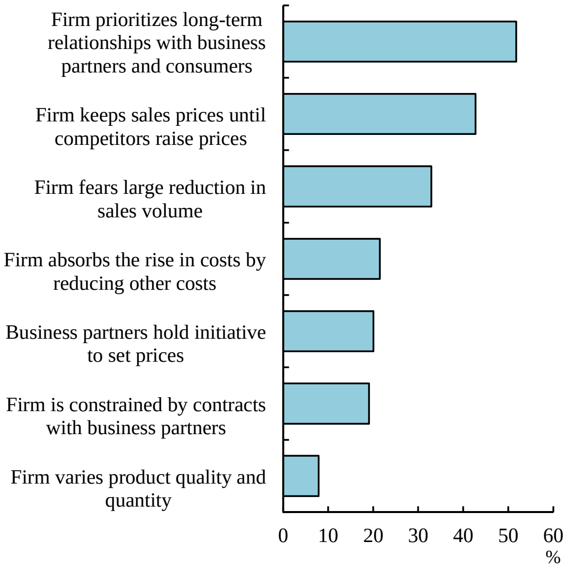
- ✓ Large room for firms to raise productivity
- ✓ Technological progress in recent years
- ✓ High wage elasticity of labor supply

The pace of improvement in prices and inflation expectations has remained slow compared to the improvement in the output gap.

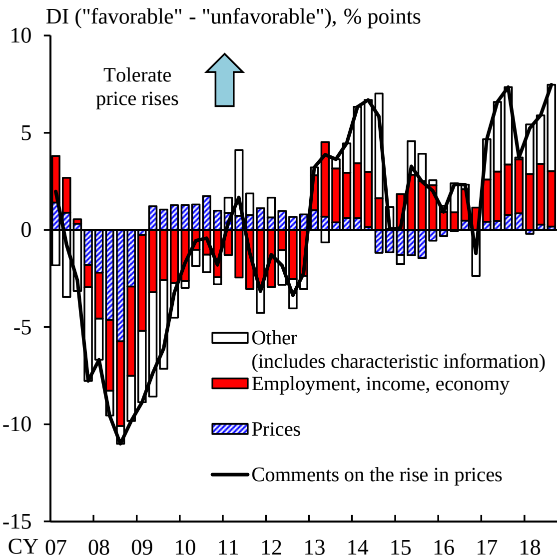
1. Firms' cautious wage- and price-setting stance
2. Sluggish increase in households' tolerance of price rises
3. Intensifying competition

Factors related to Mindset

Reasons for Not Passing On Cost Increases to Sales Prices (2013)



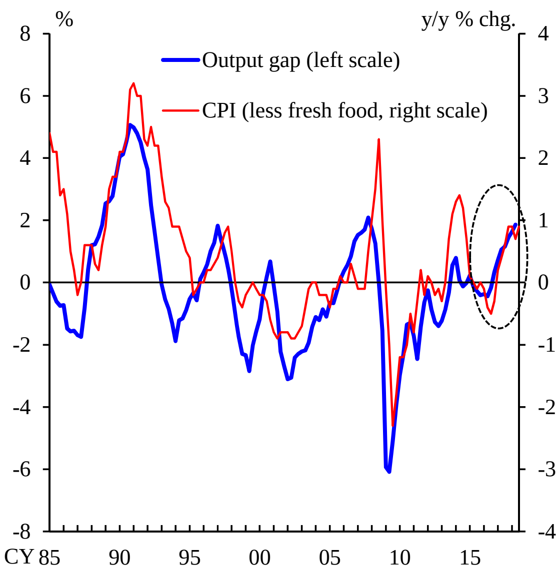
Households' Tolerance of Price Rises



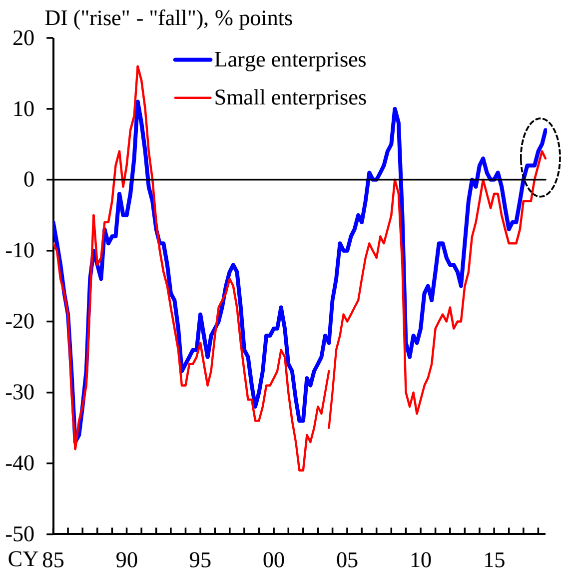
Notes: 1. Figures in the left chart are based on a survey of 3,030 listed and 2,970 non-listed firms conducted by the Cabinet Office (2013).
2. In the right chart, comments on the rise in prices are chosen among three alternatives: "rather favorable," "difficult to say," and "rather unfavorable." Estimation is done using effective samples in which all the relevant questions for the estimation were answered. Figures show deviations from the displayed period average.
Sources: Cabinet Office (2013), "Annual Report on the Japanese Economy and Public Finance 2013"; Bank of Japan.

Environment Surrounding Prices

Output Gap and Prices



Output Prices DI (Tankan)

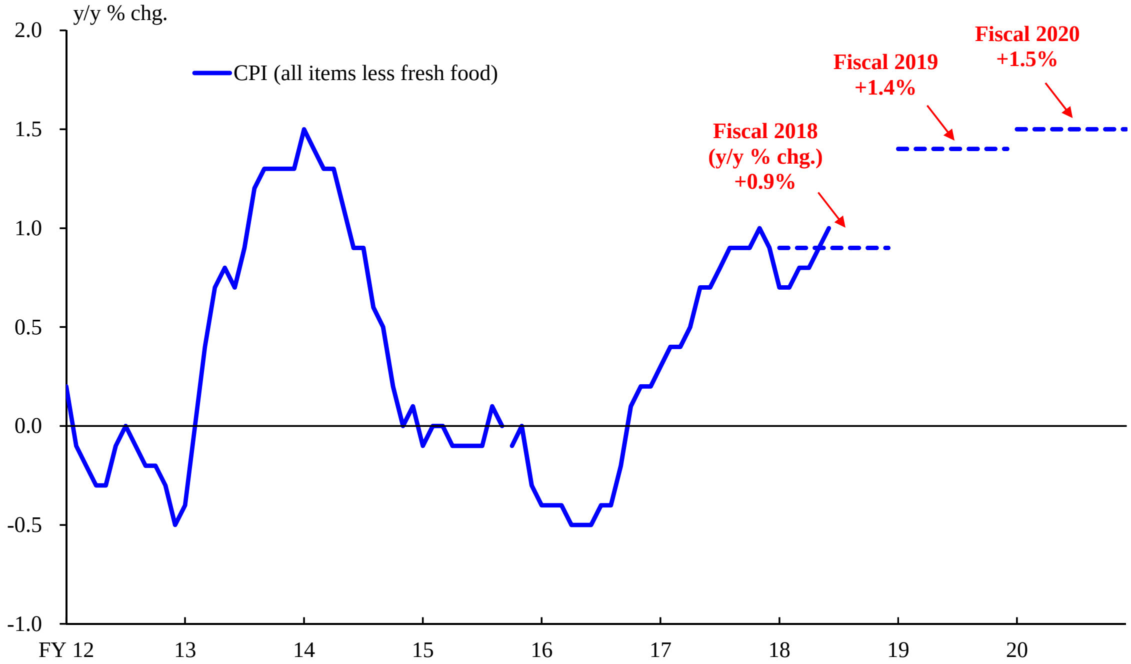


Notes: 1. The CPI figures are adjusted for changes in the consumption tax rate. The output gap is based on BOJ staff estimations.
2. There is a discontinuity in the data of the output prices DI in December 2003 due to a change in the survey framework.
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

II. Price Developments

BOJ's Forecasts of the CPI

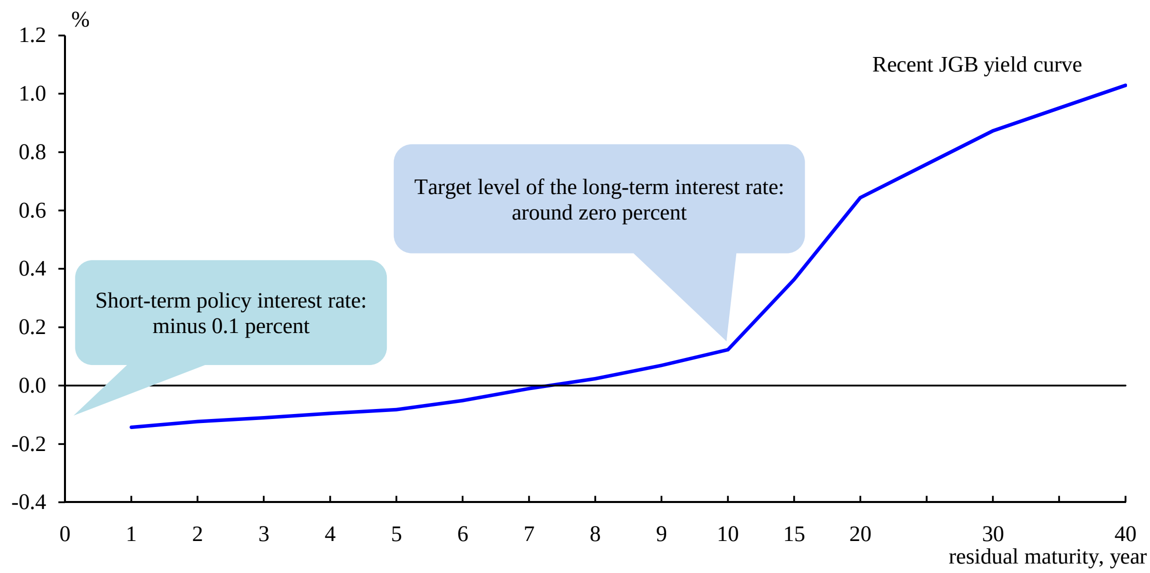
(October 2018 Outlook Report)



Note: Figures are adjusted for changes in the consumption tax rate. Forecasts are the medians of the Policy Board members' forecasts excluding the effects of the scheduled consumption tax hike (point estimates).
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

III. The Bank's Conduct of Monetary Policy

Yield Curve Control



Source: Bloomberg.

III. The Bank's Conduct of Monetary Policy

Chart 13

Strengthening the Framework for Continuous Powerful Monetary Easing

(Decided on 31 July, 2018)

Taking more time than expected to achieve the price stability target of 2 percent.
Maintaining the output gap as long as possible within positive territory is appropriate.

⇩

Persistently Continuing with Powerful Monetary Easing

Forward guidance for policy rates

"The Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019."

⇒ Strengthening the commitment to achieving the price stability target

Enhancing the sustainability of "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control"

Long-term interest rate: The Bank maintains the target level of around zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices.

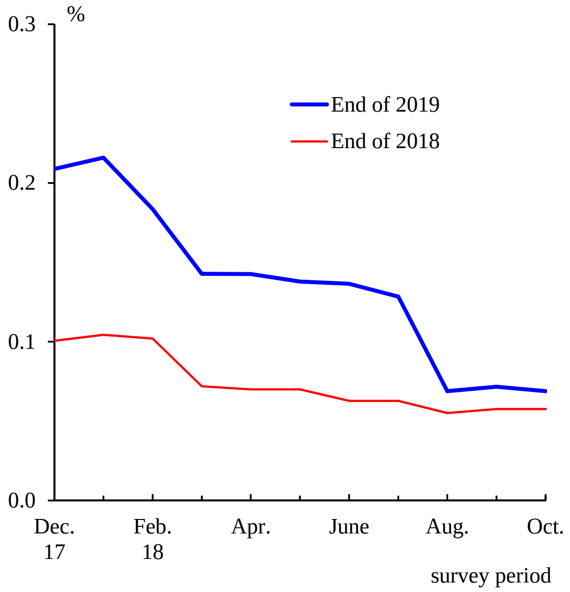
Purchases of ETFs: The Bank maintains the annual pace of increase in the amount outstanding of about 6 trillion yen. While doing so, the Bank may increase or decrease the amount of purchases depending on market conditions. etc.

III. The Bank's Conduct of Monetary Policy

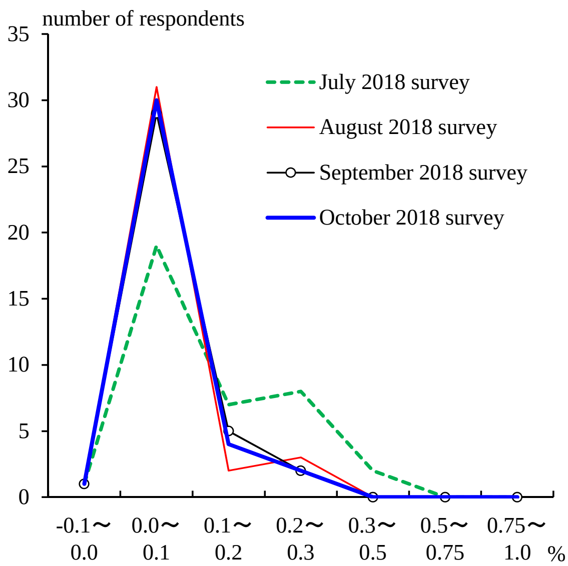
Chart 14

Forecasts for the Target Level of the Long-Term Interest Rate

Weighted Averages (End of 2018 and 2019)



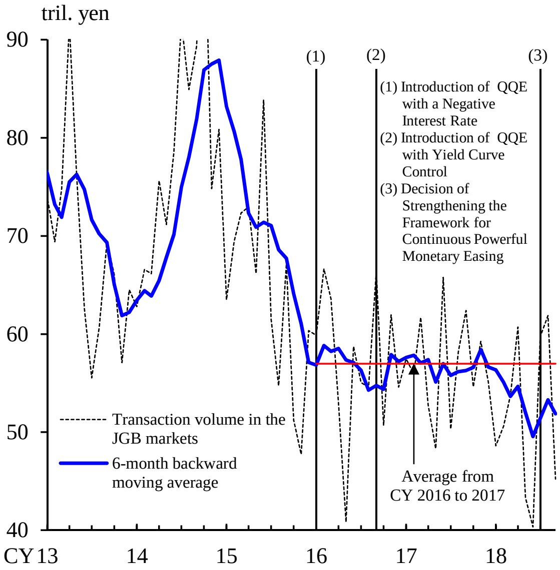
Distribution (End of 2019)



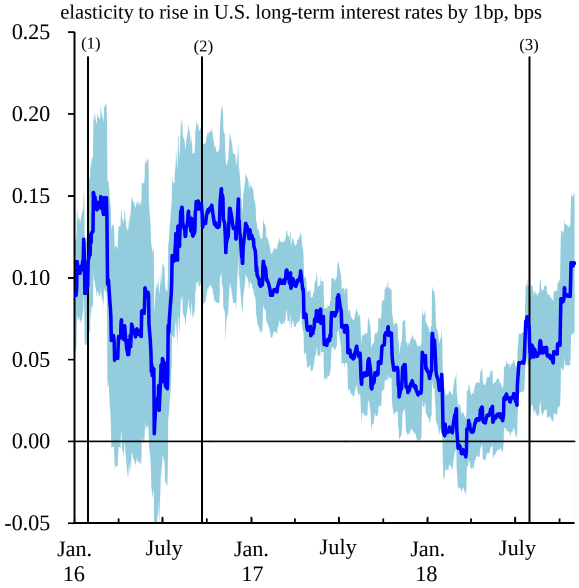
Source: JCER, "ESP Forecast."

Functioning of the JGB Markets

Transaction Volume in the JGB Markets



JGB Yield Elasticity to U.S. Long-Term Interest Rates



Notes: 1. Transaction volume in the left chart is the gross amount purchased by banks, investors, and bond dealers.
2. Figures in the right chart are slopes in a simple regression model (90-day backward rolling regression) in which the dependent variable is daily changes of 10-year JGB yields and the explanatory variable is daily changes of 10-year U.S. Treasury yields (one-period lag). Shaded areas indicate ±1 standard error bands.

Sources: Bloomberg; JSDA.