

# Basic Thinking on Monetary Policy and the Outlook for Economic Activity and Prices

*Speech at a Meeting Held by the Naigai Josei Chosa Kai  
(Research Institute of Japan)*

May 19, 2023

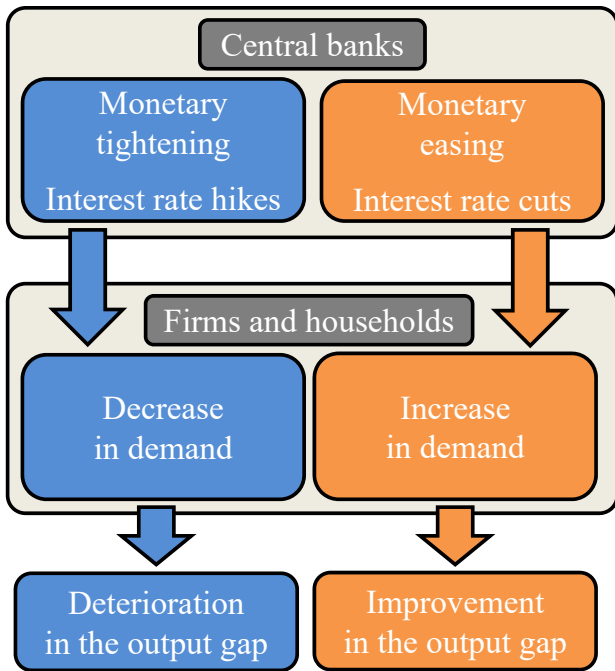
UEDA Kazuo  
*Governor of the Bank of Japan*

## Introduction

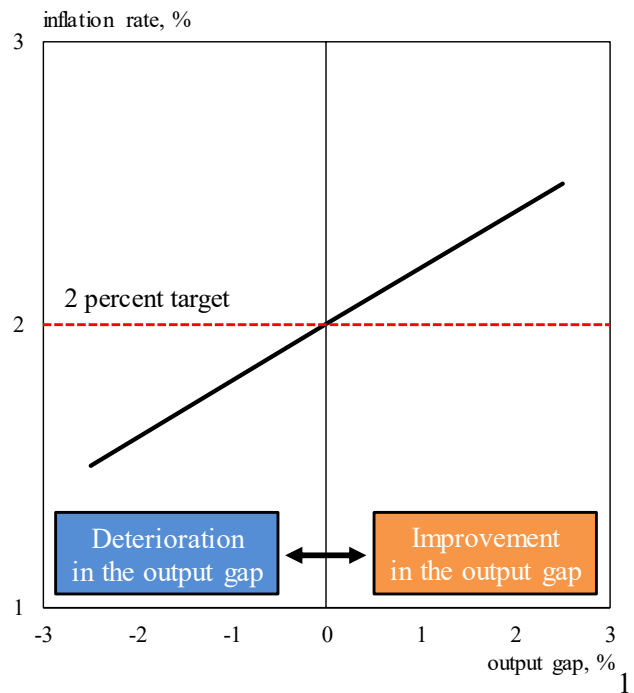
- I. The Basic Thinking on Monetary Policy
- II. Outlook for Economic Activity and Prices  
and the Conduct of Monetary Policy

## Mechanisms of Conventional Monetary Policy

(1) Relationship between Interest Rates and Economic Activity

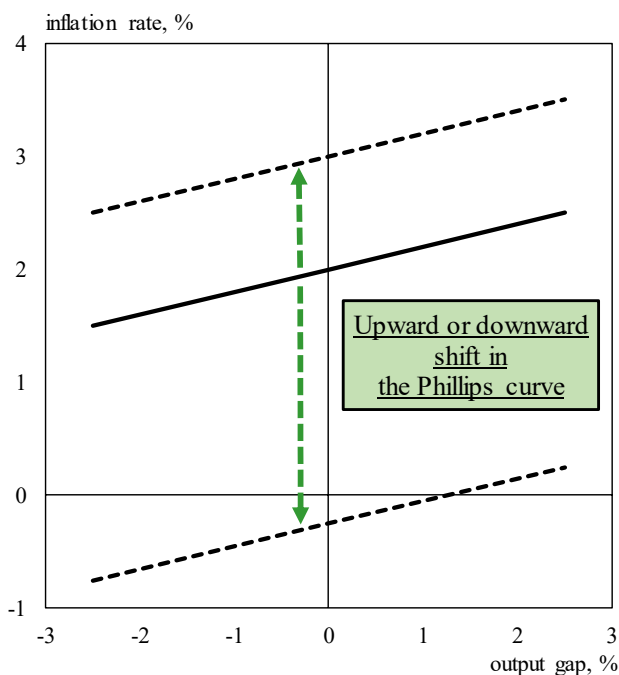


(2) Relationship between Economic Activity and Prices (Represented by the Phillips Curve)

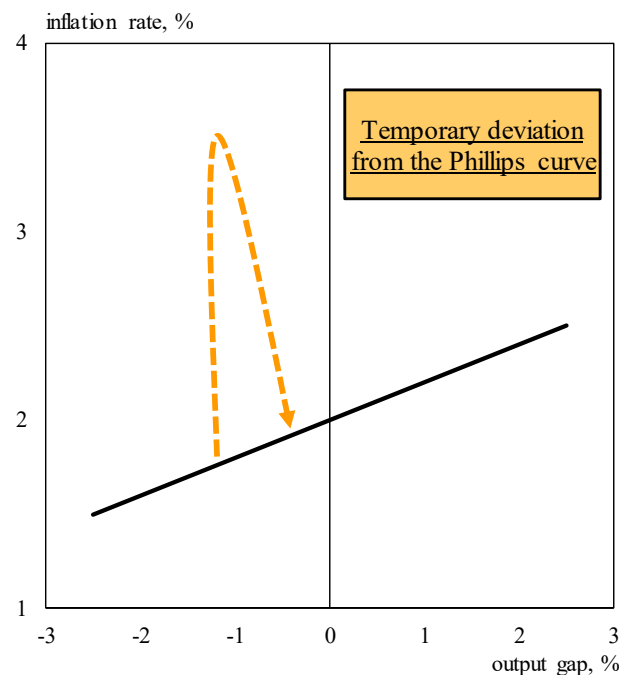


## Determinants of Inflation Other than the Output Gap and Their Effects

Inflation Expectations



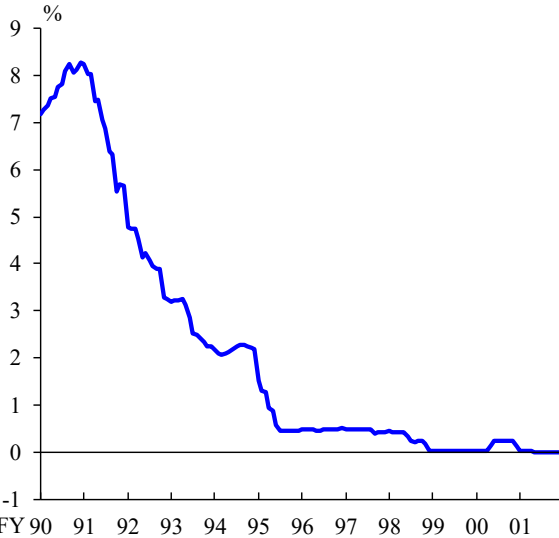
Temporary Supply Shocks



## The Two Challenges since the Bursting of the Bubble Economy

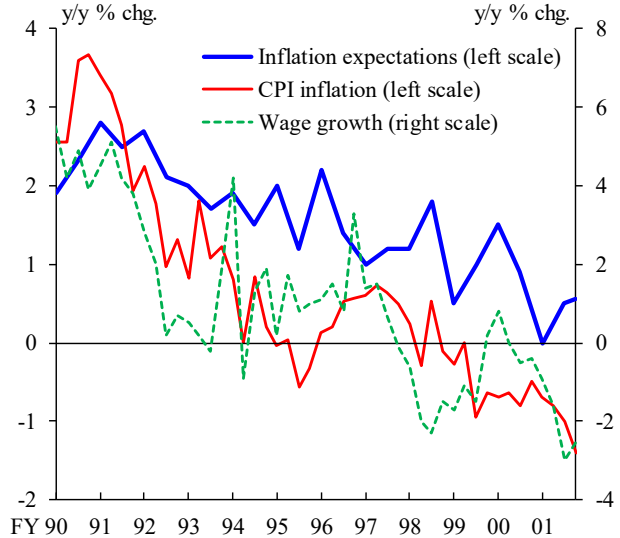
(1) Lower Bound on Interest Rates

*Overnight Rate*



(2) The Entrenched Mindset and Behavior Based on the Assumption That Wages and Prices Will Not Rise

*Inflation Expectations*

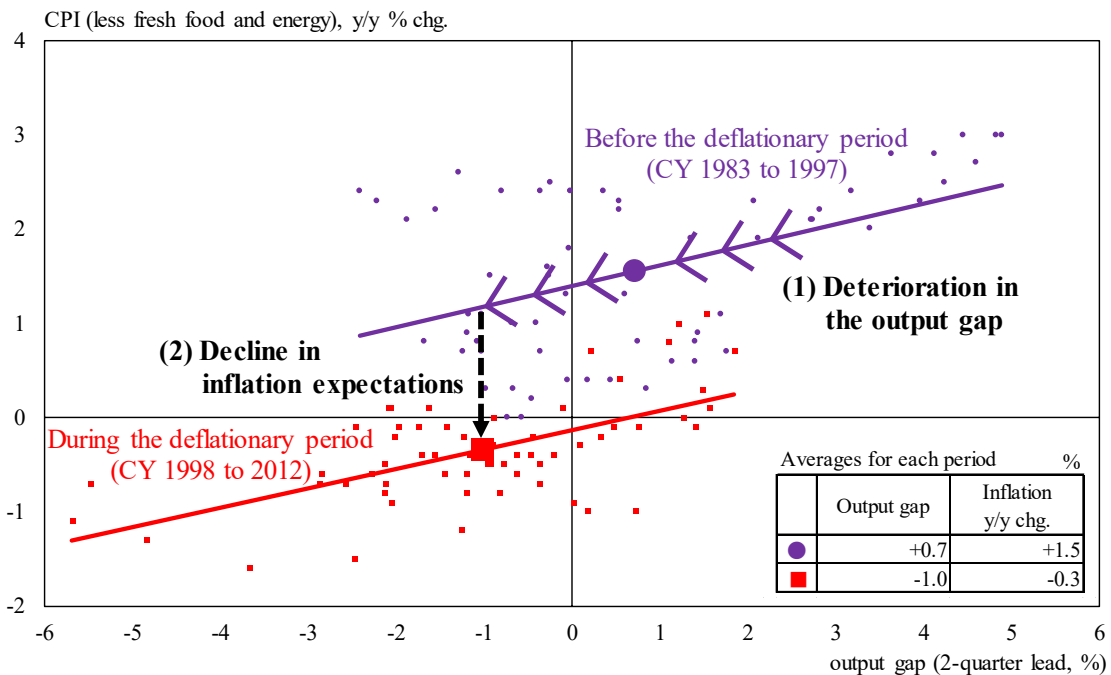


Notes: 1. In the left-hand chart, figures are monthly averages of the uncollateralized overnight call rate.

2. In the right-hand chart, figures for inflation expectations are economists' forecasts for 6 to 10 years ahead. Figures for CPI inflation are for all items excluding the effects of the consumption tax hike. Figures for wage growth before the January-March quarter of 1991 are for establishments with 30 or more employees, while figures from that quarter onward are for establishments with 5 or more employees.

Sources: Bank of Japan; Consensus Economics Inc., "Consensus Forecasts"; Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare.

## Changes in the Phillips Curve through the Deflationary Period



Note: The CPI figures exclude fresh food and energy, for which prices are volatile. They also exclude temporary factors, which consist of mobile phone charges and the effects of the consumption tax hikes, policies concerning the provision of free education, and travel subsidy programs. These Phillips curves are based on statistical estimates and should be interpreted with some latitude (the same applies to Charts 6 and 12).  
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

## Evolution of Unconventional Monetary Policy and Quantitative and Qualitative Monetary Easing

### Evolution of Unconventional Monetary Policy

\* Each policy was first introduced by the central banks shown in parentheses.

- Apr. 1999: Introduction of the idea of the policy duration effect (forward guidance) (Bank of Japan)
  - Commitment to continue with the existing monetary policy until deflationary concern is dispelled
- Mar. 2001: Introduction of quantitative easing (Bank of Japan)
  - Change in the target for market operations from the uncollateralized overnight call rate to the outstanding balance of the current accounts at the Bank
- From Nov. 2008 onward: Introduction of large-scale asset purchases (Federal Reserve)
  - Purchases of mortgage-backed securities, which are risk assets, and U.S. Treasury securities at a large scale
- July 2012: Introduction of negative interest rate policy (Danmarks Nationalbank)
- Sept. 2016: Introduction of yield curve control (YCC) (Bank of Japan)
  - Maintain the short-term policy interest rate at minus 0.1 percent and the 10-year JGB yields at around zero percent

### BOJ's Quantitative and Qualitative Monetary Easing (From Apr. 2013 Onward)

- Commitment with regard to the future conduct of monetary policy
- Lowering of long-term interest rates through large-scale purchases of JGBs
  - Introduction of negative interest rate policy in Jan. 2016 and YCC in Sept. 2016
- Lowering of risk premiums in stock markets, etc. through purchases of risk assets such as ETFs

#### Positive Effects

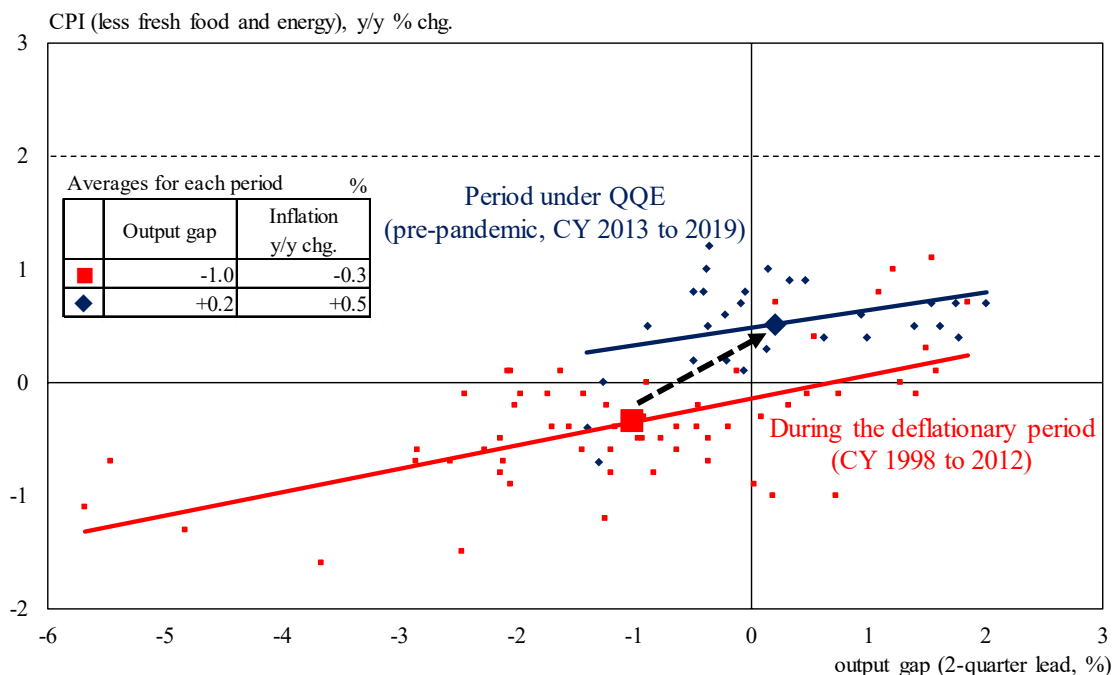
- Economic improvement, significant increase in employment
  - Achievement of a situation where Japan's economy is no longer in deflation
- ⇒ Effective in pushing up economic activity and prices

#### Side Effects

- Impact on the functioning of financial intermediation
  - Impact on market functioning
- ⇒ BOJ responded by devising various measures

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## Changes in the Phillips Curve since the Introduction of QQE

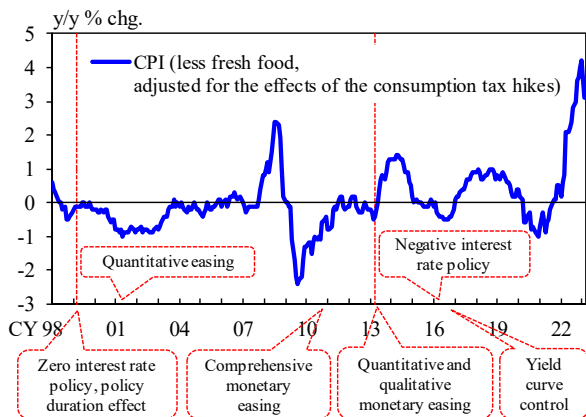


Note: Figures for the CPI (less fresh food and energy) exclude temporary factors (see note in Chart 4).  
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

# Monetary Policy Meeting (April 27 and 28, 2023)

## "A Broad-Perspective Review" of Monetary Policy

- Since the late 1990s, when Japan's economy fell into deflation, achieving price stability has been a challenge for a long period of **25 years**.
- During this period, the Bank has implemented various monetary easing measures. These measures have interacted with and influenced wide areas of Japan's economic activity, prices, and financial sector.
- In light of this, the Bank has decided to conduct a broad-perspective review of monetary policy, **with a planned time frame of around one to one and a half years**.



## Stance on Future Conduct of Monetary Policy

- The Bank reexamined **its stance on the future conduct of monetary policy**, given the reclassification of COVID-19 under the Infectious Disease Control Law and a decline in the risk of COVID-19 affecting economies and financial markets at home and abroad.

### Newly Included Its Basic Stance in the Statement

With extremely high uncertainties surrounding economies and financial markets at home and abroad, the Bank will **patiently continue with monetary easing** while **nimbly responding** to developments in economic activity and prices as well as financial conditions. By doing so, it will aim to achieve the price stability target of 2 percent in a sustainable and stable manner, accompanied by wage increases.

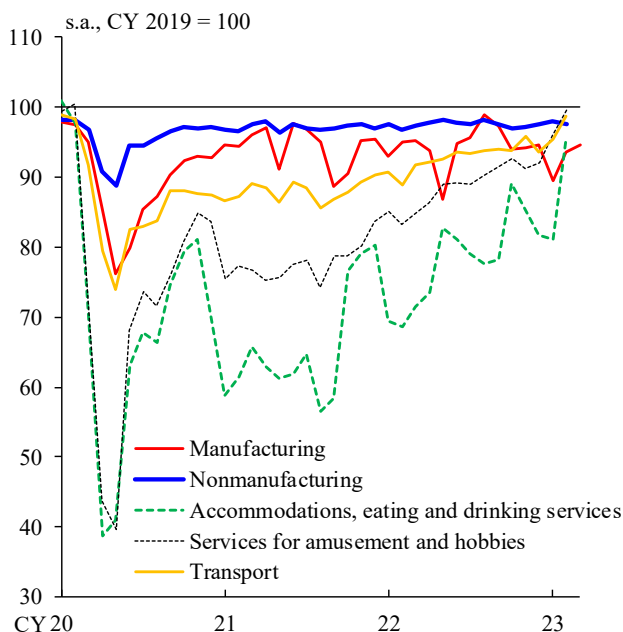
### Maintained the Following Stance

The Bank will continue with QQE with Yield Curve Control, aiming to achieve the price stability target, as long as it is necessary for maintaining that target in a stable manner. It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner. The Bank will continue to maintain stability of financing, mainly of firms, and financial markets, and **will not hesitate to take additional easing measures if necessary**.

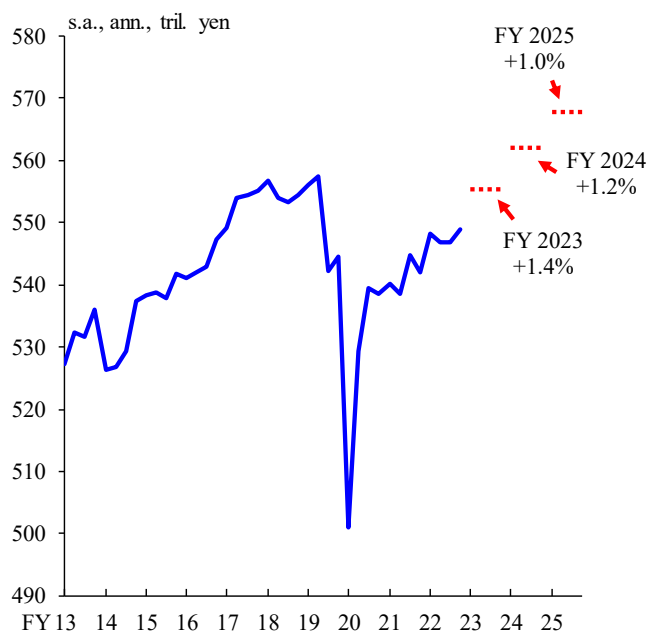
## II. Outlook for Economic Activity and Prices and the Conduct of Monetary Policy

# Japan's Economy

*Economic Activity by Sector*



*The BOJ's Forecasts for Real GDP*



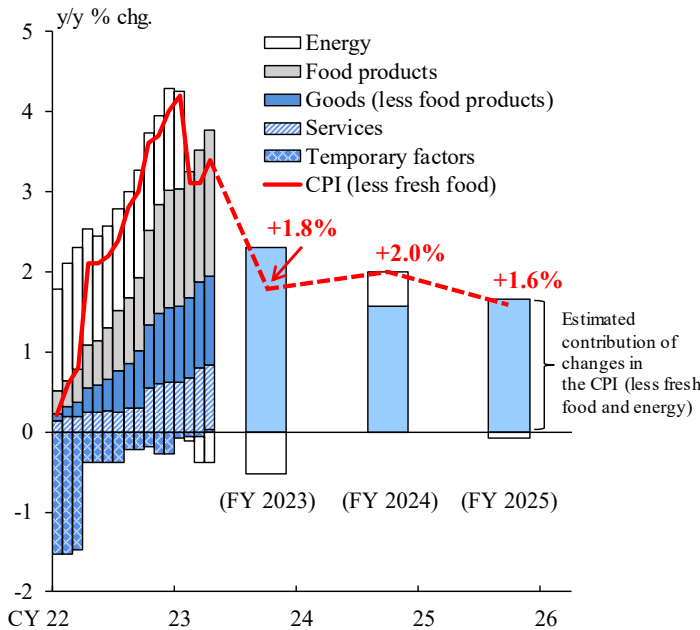
Notes: 1. In the left-hand chart, figures for manufacturing are from the Indices of Industrial Production, while those for the other sectors are from the Indices of Tertiary Industry Activity. Figures for nonmanufacturing exclude accommodations, eating and drinking services, services for amusement and hobbies, and transport.

2. In the right-hand chart, the forecasts presented are the medians of the Policy Board members' forecasts in the April 2023 *Outlook for Economic Activity and Prices* (Outlook Report). The values of real GDP for fiscal 2023 onward are calculated by multiplying the actual figure for fiscal 2022 by all successive projected growth rates for each year.

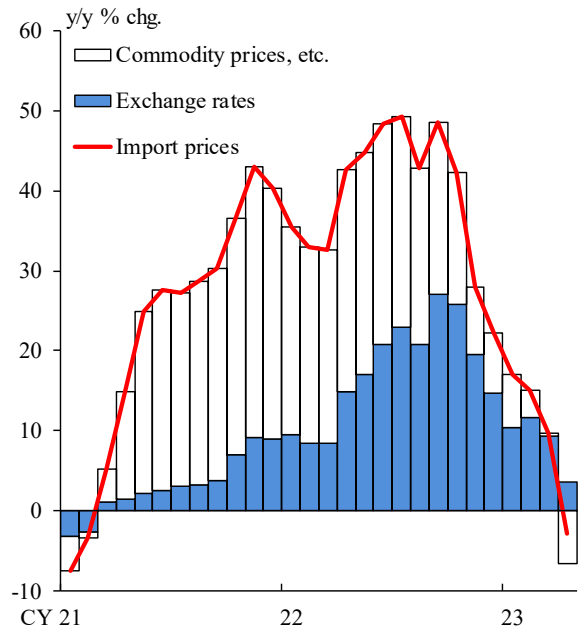
Sources: Ministry of Economy, Trade and Industry; Cabinet Office; Bank of Japan.

# Prices

The BOJ's Forecasts for the CPI



Import Prices

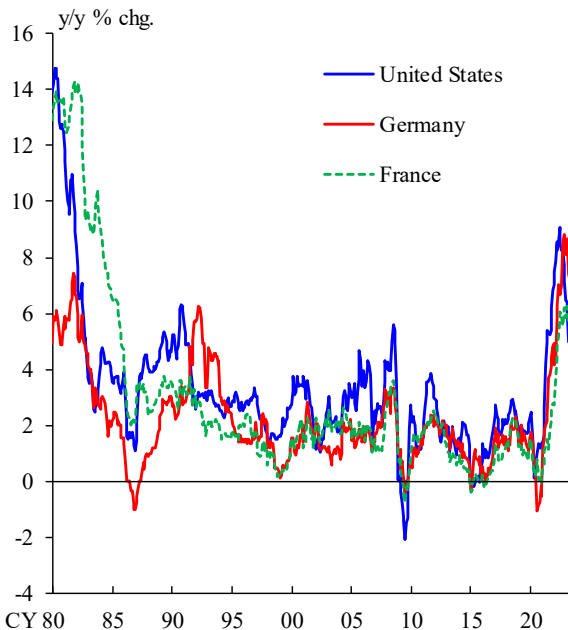


Notes: 1. In the left-hand chart, figures for temporary factors are staff estimates and consist of mobile phone charges and the effects of travel subsidy programs. The forecasts presented are the medians of the Policy Board members' forecasts in the April 2023 Outlook Report. The estimated contribution to changes in the forecasts is calculated using the medians of the members' forecasts for the CPI (all items less fresh food) and for the CPI (all items less fresh food and energy), and using the respective shares of each index in the overall CPI as weights.  
 2. In the right-hand chart, the contribution of changes in commodity prices, etc. is calculated using changes in the import price index on a contract currency basis. The contribution of changes in exchange rates is calculated using the difference between the index on a yen basis and that on a contract currency basis.

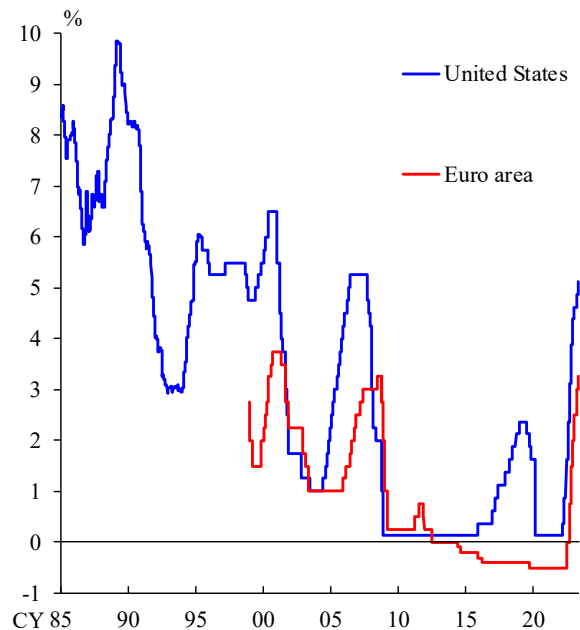
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

# Overseas Economies

Inflation



Policy Interest Rates



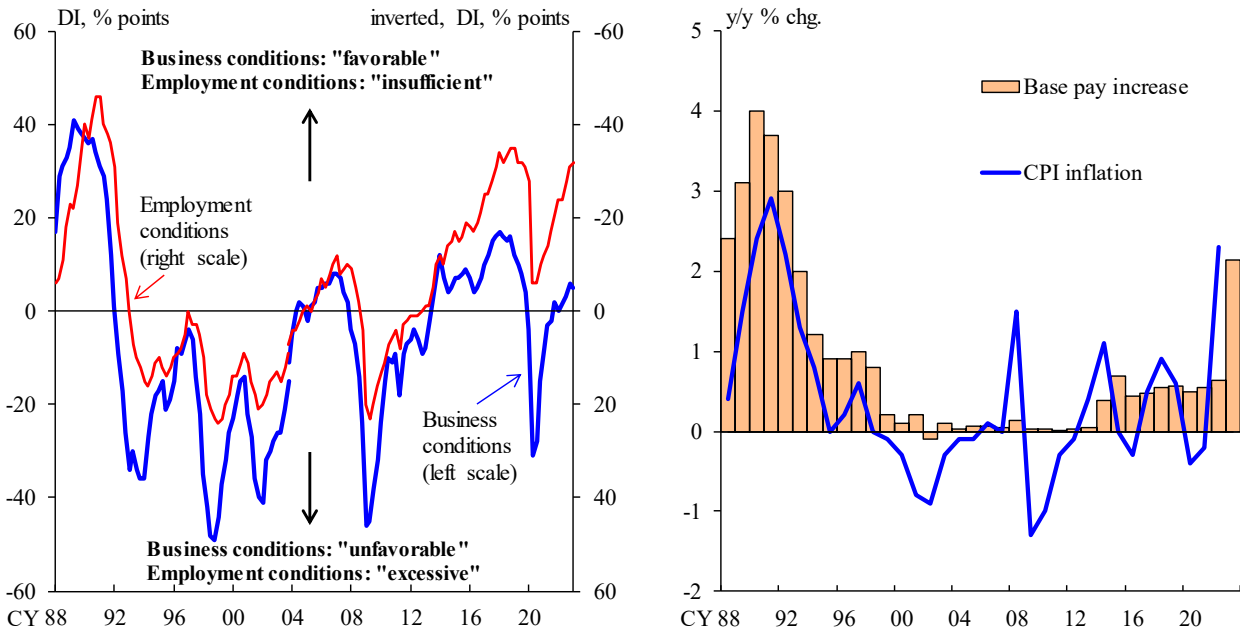
Notes: 1. In the left-hand chart, figures are based on national statistics compiled by the OECD.  
 2. In the right-hand chart, figures for the United States are the federal funds target rate or the medians of the target ranges. Those prior to July 1995 are monthly averages of the effective federal funds rate. Figures for the euro area are the rates on the deposit facility.

Sources: Haver; Bloomberg.

# Wages

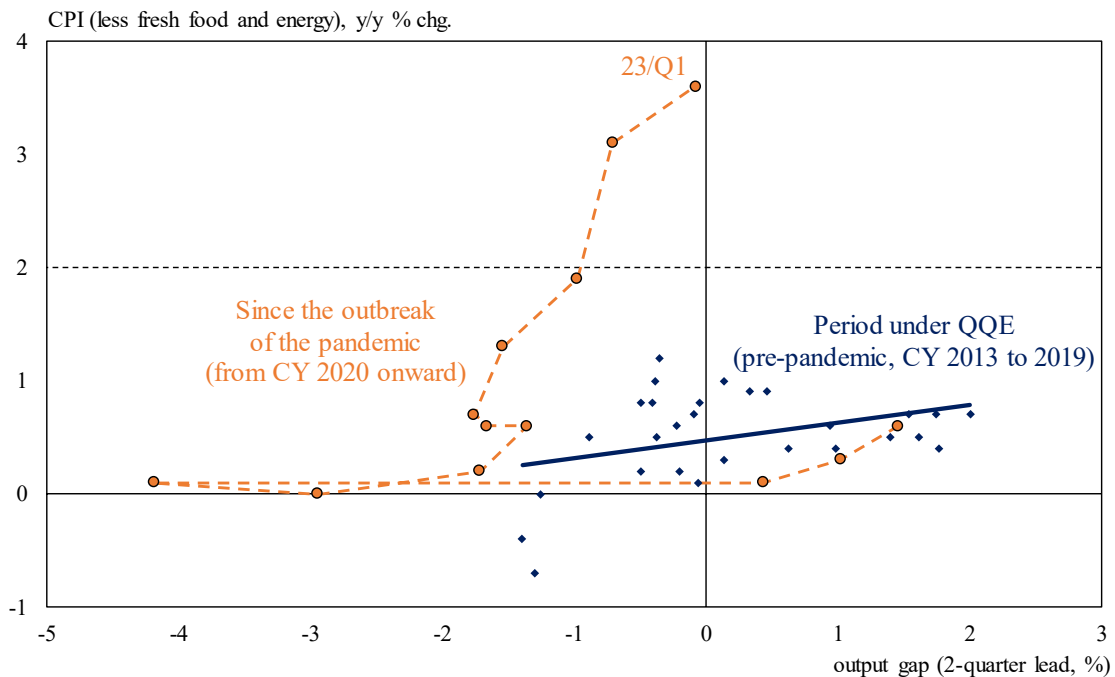
## Business and Employment Conditions in the Tankan

## Inflation and Base Pay Increase



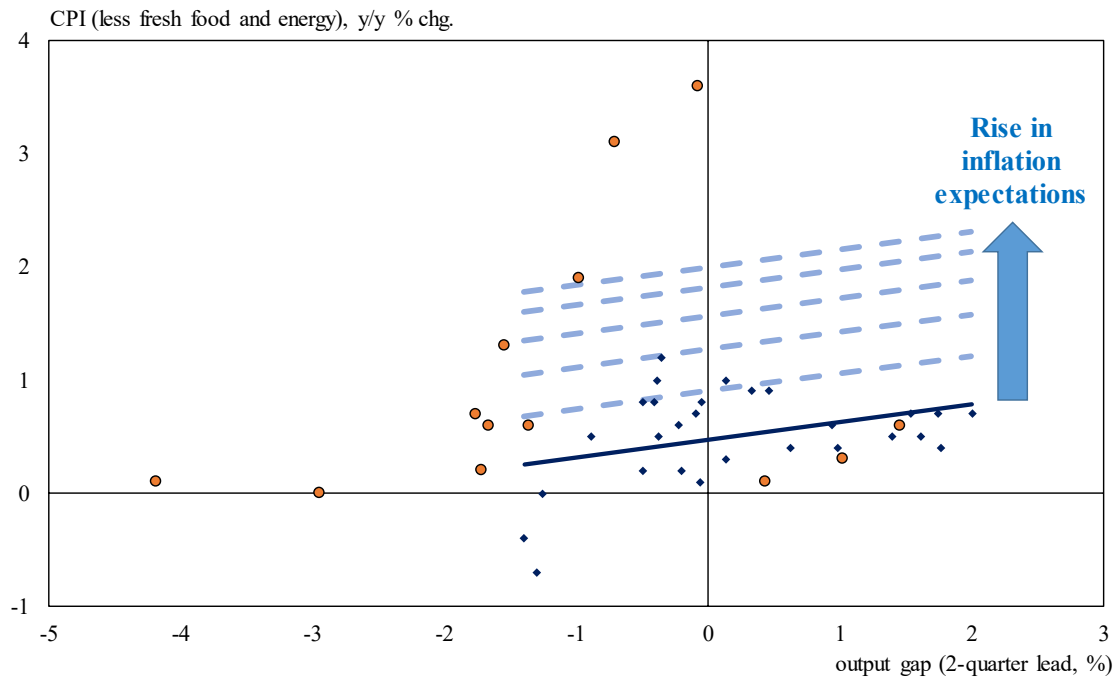
Notes: 1. In the left-hand chart, figures are for all industries and enterprises. There is a discontinuity in the data for December 2003 due to a change in the survey framework.  
 2. In the right-hand chart, figures for CPI inflation are for all items less fresh food, excluding the effects of the consumption tax hikes, etc. The figure for base pay increase for 2023 is from Rengo's fifth aggregation.  
 Sources: Bank of Japan; Ministry of Internal Affairs and Communications; Japanese Trade Union Confederation (Rengo); Central Labour Relations Commission; Institute of Labour Administration.

# Phillips Curve before and after the Pandemic



Note: Figures for the CPI (less fresh food and energy) exclude temporary factors (see note in Chart 4).  
 Sources: Ministry of Internal Affairs and Communications; Bank of Japan.

# Upward Shift in the Phillips Curve



Note: Figures for the CPI (less fresh food and energy) exclude temporary factors (see note in Chart 4).  
Sources: Ministry of Internal Affairs and Communications; Bank of Japan.