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Bank of Japan

Recent Economic and Financial Developments and the Conduct of Monetary Policy

Summary of a Speech at a Meeting with Business Leaders in Kushiro

Tadao Noda

Member of the Policy Board

I. The Economy and Prices: Current State and Outlook

Let me begin with the current state of and outlook for Japan's economy and prices.

A. The Economy

Between fiscal 2003 and 2006, Japan's economy grew at annual rates of around 2.0 to 3.0 percent. Economic growth subsequently slowed to 1.6 percent in fiscal 2007, decelerated further at the beginning of fiscal 2008, and has been sluggish most recently.

The first reason behind the sluggishness of the economy is the rise in energy and materials prices. International commodity prices have soared since the beginning of 2007. For example, the price of West Texas Intermediate (WTI) crude oil shot up to around 145 U.S. dollars per barrel and then eased to the present level of 100-110 dollars. Still, the price is five times higher than that recorded in 2002, when it stood at 21 dollars per barrel, and is about 30 percent above the level a year ago. Japan depends heavily on imports of resources, whose prices have risen sharply, and therefore, import prices have soared. In contrast, export prices of industrial products, which make up the largest share of Japan's exports, have remained more or less unchanged. As a result, the terms of trade -- export prices divided by import prices -- have deteriorated. This deterioration in the terms of trade represents an outflow of income, or a decrease in real income, which exerts downward pressure on corporate profits and reduces households' purchasing power and leads to a downturn in investment and consumption.

The second reason behind the sluggishness of the economy is weaker growth in exports. Overseas economies as a whole -- not only those of the United States and Europe, but also of emerging economies -- are decelerating, and the impact of that deceleration is likely to affect Japan's exports before long.

While Japan's economic growth will likely remain sluggish for the time being for these reasons, it is expected to return gradually onto a moderate growth path as commodity prices stabilize and overseas economies move out of their deceleration phase. However, it must be admitted that the uncertainties surrounding this scenario are very high. I will touch upon this point as risk factors later in my speech.

B. Prices

Prices have been on the rise. The year-on-year rate of increase in the consumer price index (CPI) excluding fresh food, or the core CPI, has been rising since the end of 2007. In July, the year-on-year rate of increase in the core CPI reached 2.4 percent. This was the highest rate in 16 years excluding fiscal 1997, when CPI inflation increased reflecting the rise in the rate of consumption tax. The recent rise in the CPI has been above the range of 0 to 2 percent -- the so-called "understanding of medium- to long-term price stability" -- that is, the level of inflation that each member of the Policy Board understands as being consistent with price stability over the medium to long term. A closer look, however, reveals that the rise is attributable almost wholly to rises in prices of energy, including petroleum products, and food, including the cost of dining out. In other words, there have been no signs of second-round effects, where a rise in primary commodity prices leads to a rise in wages, causing the pass-through of higher costs to sales prices. This synergistic process, constituting a fundamental inflationary factor, must be watched with caution.

Nominal wages have increased on a year-on-year basis since the beginning of 2008, but the rate of increase has recently slowed. Given the rapid deterioration in income generation due to the changes in the terms of trade mentioned earlier, it is unlikely that this decelerating trend will be reversed in the immediate future. Second-round effects are unlikely to emerge given the weakness in domestic demand.

As far as we can see, a rebound in the prices of primary commodities should not prevent consumer price increases from moderating gradually and leveling off, unless commodity prices continue to rise beyond their previous peaks marked two months ago.

Japan's economy has not faced a level of inflation this high in recent years. Furthermore, the rise in prices has been pronounced in gasoline and food -- goods that are purchased frequently. Therefore, inflation as perceived by households may in fact be higher than the actual rate of change in the CPI, as suggested by many survey results, such as the Bank's *Opinion Survey on the General Public's Views and Behavior*.[1] The 10 percent trimmed-mean CPI, which is considered to be a relatively reliable gauge of the underlying price trend, rose by around 1.0 percent on a year-on-year basis, while the difference between the number of goods whose price increased and those whose price decreased jumped to 152 in July from 119 in June. These facts indicate that firms are increasingly passing on higher costs to sales prices. Therefore, careful attention should be paid to the possibility that changes in the inflation expectations of households and firms' price-setting behavior as well as wage revisions may trigger second-round effects.

II. Risk Factors Surrounding Japan's Economy

A. Uncertainties Regarding Global Financial Markets and Overseas Economies

I said earlier that Japan's economy was likely to return gradually onto a moderate growth path. This outlook, the main scenario, rests on two underlying assumptions: (1) prices of energy, materials, and other international commodities stabilize; and (2) overseas economies move out of their deceleration phase. Violation of these two assumptions poses the greatest threat to the likelihood of our main scenario materializing.

Let us look first at developments in global financial markets. Global financial markets remain nervous. The U.S. subprime mortgage problem, which underlies the disruptions in global financial markets, emerged in the summer of 2007. The flames lit by the U.S. subprime mortgage problem spread like wildfire and triggered concerns about the downgrading of securitized products and possible further losses at financial institutions. Since the problem first emerged, more than a year has passed, but there are no signs of the flames dying down. Not a day passes without bold headlines including the word "subprime" -- the current buzzword -- appearing in economic

[1] The Bank conducts the *Opinion Survey on the General Public's Views and Behavior* on a quarterly basis. The survey conducted in June 2008 showed that more than 90 percent of respondents felt that prices had increased from a year earlier, with 40.8 percent considering the rise significant, and 51.3 percent slight. Furthermore, when asked how large they thought the annual price increase was, the respondents' average was an increase of 10.2 percent, up from 7.6 percent in the previous survey, while the median was 10.0 percent, up from 5.0 percent in the previous survey.

reporting.

Before discussing the outlook for global financial markets, I would like to briefly look back on the developments since the summer of 2007. At the first stage, the root of the problem appeared to be the repricing, or reassessment, of securitized products backed by subprime loans. This adjustment soon spread to other types of securitized products, making it increasingly difficult to raise funds through securitization more generally and causing "liquidity constraints." Then the second stage emerged: the time of "credit contraction." The declines in the prices of securitized products increased financial institutions' losses and consequently financial institutions tightened their credit standards. The current stage is the emergence of a negative feedback loop between financial markets and economic activity, where the credit contraction slows the economy, and the sluggishness in the economy causes financial institutions' asset quality to deteriorate further, further accelerating the credit contraction.

In the United States, where the problem originated, the liquidity position of Bear Stearns, the fifth largest investment bank, deteriorated and it had to be rescued from bankruptcy in March by JPMorgan Chase, a major commercial bank, with the financial support of the Federal Reserve, the central bank. On September 7, two government-sponsored enterprises (GSEs) -- Fannie Mae and Freddie Mac -- were placed into conservatorship by the U.S. government. A week later, Lehman Brothers, the fourth largest investment bank, collapsed, and Merrill Lynch, the third largest, was rescued and merged with the Bank of America. In a matter of six months, three out of the five leading investment banks either failed or were taken over. Furthermore, American International Group (AIG), the world's largest insurance company, came under effective control of the U.S. government through the extension of emergency loans by the Federal Reserve secured against the entire assets of AIG.

These developments reignited concerns about the creditworthiness of U.S. and European financial institutions. Their stock prices dropped sharply, and the dwindling of liquidity in U.S. dollar short-term funding markets sent interest rates surging, causing significant intraday fluctuations. To address this situation, the Bank of Japan, the

Federal Reserve, and four other central banks announced on September 18 coordinated measures to introduce and increase U.S. dollar funds-supplying operations. The Bank conducted its first-ever auction to supply 30 billion dollars on September 24. Furthermore, the U.S. government announced on September 20 a plan to use public funds to purchase up to 700 billion dollars worth of troubled assets from U.S. financial institutions over a period of two years to forestall a worsening of the financial crisis.

The causes of the current market turmoil are complex, and no simple explanation can be provided. One thing, however, is certain. The extended period of price stability and an accommodative financial environment from around 2002 led to an expansion of leverage[2] through a series of sophisticated securitized products. During this period, risk evaluation by market participants became lax and this laxity has since undergone a reversal through the self-correcting forces of the market with an inevitable repricing of risk.

In this context, two issues are of particular importance: (1) the size of the losses financial institutions carry on their balance sheets; and (2) the restoration of their balance sheets, in other words, the reinforcement of their capital base. According to a survey by a major U.S. financial institution, as of September 15, losses of financial institutions such as banks, brokers, insurance companies, asset management firms, and financial guarantors in the United States and Europe since the U.S. subprime mortgage problem emerged amount to 560.2 billion dollars, of which 389.6 billion dollars have been covered by capital reinforcement. The swift reaction to the critical situation -- especially compared with the Japanese experience in the past -- has been lauded in some quarters. However, the crucial issue -- that is, the final size of the losses, including loan-loss reserves and write-offs for lending connected with securitized products -- is still unclear. In the United States, the housing market, the very source of the crisis, is still undergoing adjustment, with the tightening of lending standards spreading from mortgage loans to commercial real estate and consumer loans. Moreover, a negative feedback loop, where the damage in the balance sheets of financial institutions caused

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[2] Leverage refers to the attempt to raise the return on equity through the issuance of bonds or the use of loans.

by the deterioration in the economy, in turn causes damage to the economy, is coming in sight. With the Japanese experience of the 1990s in mind, I am concerned that difficulty in funding capital felt by U.S. and European financial institutions after the defaults of some U.S. financial institutions may add fuel to the process of a negative feedback loop. An International Monetary Fund (IMF) official said at a conference on September 24 that the IMF estimated total losses for the global financial system from the turmoil stemming from the U.S. subprime mortgage problem to be 1.3 trillion dollars. The market remains cautious with regard to possible further losses financial institutions might incur, and it will not be until the clouds of such uncertainty have cleared that the market will return to normal. The plan by the U.S. government to purchase troubled assets might help the markets to return to normality, but we cannot be certain before the details of the plan are made public.

Turning to recent developments in overseas economies, the U.S. economy has been sluggish. Although private consumption temporarily recovered due to the effects of tax rebates, it is likely to remain weak as consumer sentiment remains highly cautious reflecting rises in gasoline and food prices as well as the deterioration in employment conditions. Housing investment continues to decrease substantially while home prices are falling. The slowdown in business fixed investment has become more evident, and industrial production has been relatively weak.

Regarding the outlook for a recovery of the U.S. economy, two downside risks need to be pointed out. The first downside risk is heightening concerns that the turmoil in financial markets may set in motion a negative feedback loop between financial markets and economic activity. The lending attitudes of U.S. and European financial institutions are, at present, the tightest since the central banks of the United States and Europe started their surveys in 1990 and 2003, respectively. From past experience we know that credit tightening, after some time lag, exerts a negative effect on the demand for business fixed investment, including commercial real estate, and so it is possible that the current credit tightening will, sooner or later, reduce such demand further. Financial institutions that suffer impaired capital have no choice but to take a more cautious stance on lending, as was the case in Japan in the 1990s. The financial system is the life-blood of the economy, and if its flow is impeded, this will inevitably have an impact on the economy. Since the U.S. economy is already under pressure from the adjustment of housing and real estate values and household loans, due attention should be paid to the risk that credit problems may trigger deeper adjustments.

The second downside risk is that it will take more time for the turmoil in the U.S. housing market, the source of the problem, to subside. Here, the surplus housing inventory is a critical issue, given that home prices and single-family housing starts are still declining. Home price index futures -- though not an entirely reliable index because markets are thin -- suggest that after a fall of some 20 percent from the peak recorded in the middle of 2006, home prices may decline further by around another 20 percent by the middle of 2010. It will take some time before confidence can be placed in the main scenario that the Federal Reserve is most likely to embrace, in which the U.S. economy will return to its potential growth rate as the housing market bottoms out and financial conditions become less restrictive.

With regard to the euro area, it is becoming clearer that economies are slowing down. Reflecting the rise in energy and food prices, private consumption has decreased, and the pace of increase in business fixed investment and exports outside the euro area has decelerated.

In China, both domestic and external demand continue to expand strongly. It is true that growth in exports has slowed somewhat reflecting the slowdown in the global economy. However, consumption continues to expand. The rate of increase in fixed asset investment remains high, though it is unlikely to accelerate further in real terms due in part to macroeconomic policies introduced since last fall to rein in overheating. Overall, firms remain keen to invest. Turning to prices, growth in China's CPI in August was 4.9 percent compared with the same period a year earlier, after a rise of 6.3 percent in July. The marked slowdown in the CPI in August resulted from a leveling off of food prices. The producer price index for manufactured goods (the wholesale price index) for August posted a 10.1 percent increase from the same month a year earlier, marking double-digit growth for two consecutive months and indicating a possible acceleration of inflation, especially with the cut in renminbi benchmark lending rates.

In the NIEs and the ASEAN economies, it is apparent that the pace of economic growth is slowing as external demand continues to decelerate and the deteriorating terms of trade begin to restrain the growth of domestic demand.

To sum up developments in overseas economies, countries that import resources are expected to see a more pronounced slowdown reflecting the deterioration in their terms of trade as the U.S. economy remains sluggish. If the turmoil in financial markets subsides and the adjustment in the U.S. housing market makes progress, we are likely to see a gradual recovery in 2009 and after. My view is that, on a calendar-year basis, following a deceleration in 2008 and 2009, the growth rate is likely to pick up in 2010.[3]

Developments in the global economy, particularly in the U.S. economy, could affect Japan's exports -- the source of Japan's virtuous circle of growth -- directly as well as indirectly via developments in financial markets. Thus, the downside risk to the world economy should continue to be monitored closely as a major risk factor to Japan's economy.

B. Developments in Energy and Materials Prices

Another major risk factor is developments in energy and materials prices.

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[3] Before the U.S. economic slowdown became more pronounced, there was much talk about the so-called "decoupling theory" and the extent to which high growth in emerging economies, particularly in China, would offset any adverse impact of a slowdown in the U.S. economy. Although these economies have been able to prop up global economic growth to some extent, it is now becoming clear that it was an illusion to expect a complete decoupling. I presented my view on the "decoupling theory" in a speech on "Recent Economic and Financial Developments and the Conduct of Monetary Policy" delivered at a meeting with business leaders in Gunma in March 2008, a summary of which is available at the Bank's web site. In the speech, I argued that "the impact on Japan's exports of falls in the exports of other East Asian countries including China to the United States requires monitoring, given the international division of the production process -- that is, the process by which Japan makes intermediate goods, or more specifically parts, that are exported to other East Asian countries, where they are assembled into final consumer goods and subsequently exported to the United States."

International commodity prices have recently been in an adjustment phase after a period of rapid increases. For example, crude oil prices, which shot up to around 145 dollars per barrel only two months ago, have eased to the present level of 100-110 dollars. There are a number of views regarding the reasons for high international commodities prices. Broadly speaking, there are two main theories. The first attributes the rise to stronger demand relative to limited supply capacity, mainly from emerging economies with a high level of growth, while the second attributes it to investment and speculative funds flowing into international commodity markets due to the turmoil in financial markets. I believe a sensible answer is that both theories were at work. The decline in international commodity prices over the last two months or so is in line with a heightened awareness of the slowdown of the global economy as a whole, and it also coincides with the unwinding of positions by speculators. In the medium to long term, it is likely that demand from emerging economies for primary commodities such as crude oil will rise further, and therefore it is difficult to be optimistic that international commodity prices will return to their previous low levels.

Against this background, inflationary pressures are increasing globally, and it is now commonly accepted that there is a need to rein in inflation. The acceleration of inflation in emerging economies with a relatively high level of growth or inflation is emerging as a new risk to sustained worldwide growth and poses a serious problem.

In Japan, on the other hand, the surge in international commodity prices has led to a deterioration in the terms of trade, resulting in the outflow of income in the short term, and, by squeezing corporate profits, has had a negative impact on corporate expenditure on wages and fixed investment. Household spending has also declined through the reduction in income and real purchasing power.

Real GDP data for the April-June quarter shows a further deterioration in the terms of trade and an expansion in the trading losses. In a situation where a deterioration in the terms of trade leads to an outflow of income, it is important to look at not only GDP but also real gross domestic income (GDI)[4] and real gross national income (GNI)[5] which

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[4] Real GDI = real GDP + trading gains/losses.

take into account the outflow of income. On an annualized basis, real GDP for the April-June quarter was down by 3.0 percent from the previous quarter while real GDI and real GNI were both down by more than 4.7 percent. This shows that Japan, which depends heavily on imports of resources, has been seriously affected by the weakening of its capacity to generate income. The Japanese adage "toil and moil, but still unable to make ends meet" is a very apt description of the situation.[6]

The surge in energy and materials prices is indeed a heavy burden on Japan's economy. However, there is no choice but to accept it as a forewarning to the world of an inevitable shift to a new price structure. Japan has overcome the two oil crises in the past by making strenuous efforts to reduce the use of energy and materials in production processes. The development of energy-saving products and technology enabled Japan to become a leader in this area, and many firms successfully made the most of the adverse circumstances. Furthermore, an increasing number of firms in a wide range of industries, led by processors of materials, have begun with the recycling of used materials. I hear that here in Kushiro, users of fossil fuels are increasingly switching to biomass energy. I have been greatly encouraged to learn about this forward-looking attempt to embrace the new price structure.

There is a high possibility that investment in plants and equipment for saving energy and resources will become a driving force of a worldwide recovery in demand. If so, Japan, being a leader in technology for reducing greenhouse gas emissions, should consider this as an opportunity to further improve its capability in this area of business by utilizing its experience of the two oil crises that led to great technological advances.[7]

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[5] Real GNI = real GDI + net income from the rest of the world (for example, interest income and dividend income).

[6] For more information on Japan's recent trading losses, refer to "BOX: Recent Increase in Trading Losses" in the *Monthly Report of Recent Economic and Financial Development* for September 2008, on pages 17 and 18.

[7] According to a study by the Ministry of Economy, Trade and Industry, the ratio of primary energy supply to GDP, using a base value of 1.0 for Japan, is 1.9 for the 27 EU countries, 2.0 for the United States, 8.6 for China, and 17.4 for Russia. This indicates that Japan is one of the most energy-efficient countries in the world. High energy efficiency has been achieved through the promotion of resource productivity particularly in the industrial sector following the experience of the two oil crises. On

Surely, this is "easier said than done," but this is the point I would like to be most emphatic about.

C. Adjustment Pressure on Production Capacity and Labor

While I have already explained the two major risk factors, which are assumed in the main scenario, I would now like to briefly touch on an attendant risk factor that should be borne in mind, although it is not as large as the two major risk factors I mentioned earlier.

I agree with the prevailing view that Japan's economy is unlikely to experience a deep adjustment. One of the reasons for this is that the corporate sector as a whole is under no significant pressure to adjust production capacity, labor, or liabilities, and it seems that, compared with the last time that Japan fell into recession, Japan's economy has become more resilient to shocks that weaken economic growth.[8]

Nonetheless, downside risks to the corporate sector warrant attention as a risk factor to Japan's economy. As for business fixed investment, if downside risks to the world economy, which I mentioned as the first major risk factor, materialize to a substantial extent, corporate profits, the source of firms' spending, will decrease, and the expected rate of growth for the short to medium term will decline. Adjustment pressure on production capacity may intensify as a result, and this possibility requires careful monitoring.

As for employment, the share of non-regular employees in the total number of employees has risen to more than a third, and any adjustment in employment may therefore proceed more smoothly and quickly than in phases of economic adjustment or stagnation in the past. This will help to stabilize corporate profits, but it is also necessary to note that this may negatively affect household income, and in turn, private

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the other hand, energy conservation at the production facilities of small firms, in homes, and in offices has had only limited success, and there is room for further improvement in terms of resource productivity in Japan's economy as a whole.

[8] Other reasons for this view are that Japan's financial system and financial markets are stable compared with those in Europe and the United States, and that financial conditions in Japan remain accommodative on the whole.

consumption.

III. The Conduct of Monetary Policy

Having outlined the current state of and outlook for Japan's economy as well as the risk factors, I would now like to talk about the conduct of monetary policy. Given that monetary policy works with a lag, we at the Bank take a forward-looking perspective that looks about one and a half to two years ahead when considering the "outlook" for the economy.[9] As I discussed earlier in some detail, the Bank's assessment of the current economic situation and the main scenario for the outlook can be summarized as follows: Japan's economic growth has been sluggish; while growth will likely remain sluggish for the time being, the economy is expected to gradually return onto a moderate growth path. With this situation and scenario in mind and considering the extremely uncertain current situation, which entails various upside and downside risks, including the risk factors I explained today, all seven Policy Board members, including myself, decided, by a unanimous vote, at the Monetary Policy Meeting on September 17 to maintain the guideline for money market operations to keep the policy interest rate at 0.5 percent.

As for monetary policy in the future, it is important to assess, without any predetermined view and by carefully analyzing various data and other information available, whether downside risks to the economy will decrease, thereby increasing the likelihood of the economy realizing a sustainable growth path with price stability, or whether the probability of such risks materializing will increase. The Bank will implement its policies in an accordingly flexible manner.

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[9] In April 2008, the Bank started releasing Risk Balance Charts as a tool to visually express Policy Board members' quantitative assessments of the outlook for economic activity and prices. In July 2008, the Bank announced measures to enhance its communication regarding monetary policy, such as extending the forecast horizon for Policy Board members' projections of economic activity and prices. Given that the Bank has been granted independence, it is only natural that the Bank should seek to be accountable, avoid being complacent, and explain the process through which it arrives at its conduct of monetary policy based on its assessment of economic activity and financial developments. Making use of my experience in the private sector, I will continue to make the utmost effort to contribute to this.

IV. The Current State of Japan's Financial System

I spoke earlier about the turmoil in global financial markets stemming from the U.S. subprime mortgage problem, and perhaps some of you have concerns about the stability of Japan's financial system. I now therefore would like to talk about the current state of Japan's financial system, including the impact of the U.S. subprime mortgage problem.

To start with my conclusion, my view is that Japan's financial system, on the whole, has remained stable despite the global financial turmoil triggered by the U.S. subprime mortgage problem and heightened strains in global financial markets. Overall, risks in the banking sector relative to banks' capital position remain subdued and the robustness of the banking system against various interest rate risk and credit risk stress scenarios has remained relatively high.

Japanese banks' exposure to the U.S. subprime mortgage problem is mainly in the form of investments in structured credit products, and they are less involved in the origination and distribution of such products than U.S. and European financial institutions. While it is true that the subprime mortgage-related losses of Japanese financial institutions have increased considerably with the deepening of problems in overseas financial markets, Japanese financial institutions' current profit levels and capital strength are sufficient to absorb such losses. At the end of June 2008, Japanese deposit-taking institutions' losses on securitized products stood at 2.6 trillion yen, which includes valuation and realized losses not related to subprime loans. This is an increase of only 0.1 trillion yen from the end of March 2008 and is within the range of operating profits from core businesses, which recorded 6.1 trillion yen for fiscal 2007. Japanese banks have already reduced their exposures to subprime-related products by selling them and applying impairment procedures to them, and it is unlikely that they will experience substantial additional losses. Although the recent failure of Lehman Brothers has posed a risk of additional losses, most Japanese financial institutions seem to be able to absorb losses within their current profit levels. In any event, the situation of Japanese financial institutions is very different from that of some of their U.S. and European counterparts, which are facing growing losses.

However, attention should be paid to the fact that Japanese financial institutions' credit costs have started to increase amid the sluggishness in economic growth. According to Japanese financial institutions' quarterly financial statements for the April-June quarter of 2008, credit costs have increased mainly due to deteriorating corporate performance and an increase in the number of bankruptcies, particularly of construction and real estate firms. The overall net income of Japanese financial institutions in the April-June quarter decreased compared with the same period of the previous year, due in part to a decline in fee income, and some financial institutions even registered net losses. As I mentioned earlier, from a macroeconomic viewpoint, Japanese financial institutions possess sufficient capital strength to absorb the recent increase in credit costs, but because there is some dispersion in financial institutions' profitability and capital strength, developments in credit risk should continue to be monitored carefully.

Earlier, I said that the financial system is the life-blood of the economy and therefore developments therein have a substantial impact on growth. In this context, an advantage is that, compared with Europe and the United States, Japan's financial system and markets are less vulnerable than before. Although investors, given the increase in the number of bankruptcies, particularly in the construction and real estate sectors, are screening firms more carefully, credit markets in Japan have been stable compared with those in Europe and the United States, as seen by the fact that investors' demand for bonds with a high rating remained firm. Moreover, the lending attitudes of financial institutions have continued to be generally accommodative. The financial positions of firms as a whole have continued to be favorable, but those of small firms and of construction and real estate firms have been deteriorating. I strongly hope that financial institutions will carry out their financial intermediation function in a smooth manner without becoming excessively cautious about lending in response to changes in credit risks caused by sluggish economic growth.

V. Central Banking Operations by the Bank

Many of you may consider that the primary role of the Bank of Japan is the conduct of monetary policy, but another crucial mission is to maintain the stability of the financial system and financial markets. The Bank pursues this mission through banking operations, that is, transactions with various private financial institutions. As someone who has observed events in Japanese financial markets while working both at private financial institutions and the central bank, I can say that understanding the situation and responding to it practically on the spot through banking operations is extremely important in any type of banking business. Japanese financial markets at present remain relatively stable, although the linkage between overseas financial markets and Japanese financial markets has become stronger. The Bank continues to make the utmost effort to ensure the stability of the financial system and financial markets even in times of global financial turmoil through the appropriate conduct of central banking operations, such as money market operations.

To give you a concrete example of banking operations that applies to all areas across the country, let us consider the case of emergency financial measures in times of natural disaster such as an earthquake or a typhoon. On June 14, 2008, immediately after the earthquake in northeastern Japan's Iwate and Miyagi prefectures, the General Manager of the Bank's Sendai branch and the Director-General of the Tohoku Local Finance Bureau of the Ministry of Finance jointly announced emergency financial measures. These included a request to financial institutions in the disaster-stricken area to respond to requests for deposit withdrawals by account holders even when the holders had lost their certificate of deposit or passbook, after confirming that the request was made by the actual account holder. Similarly, here in Hokkaido in the north, emergency financial measures were implemented when a typhoon drenched the island in 2003 and when a tornado struck the town of Saroma in 2006. Obviously, money plays a vital part in our daily lives. The stable and smooth supply of cash by the Bank with the cooperation of local financial institutions is particularly important in times of emergency.

It is said that Kushiro is one of the most earthquake-prone areas in Japan, and natural disasters such as earthquakes and other incidents that may have an impact on developments in financial markets and economic activity often occur suddenly. What is more, global financial markets are active around the clock. With that in mind, I would like you to know that central banks, including the Bank of Japan, remain constantly vigilant in monitoring whether any such incidents may bring about changes in financial markets, and take proactive measures when necessary. As always, we ask for your understanding and continued cooperation in fulfilling our missions.