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Bank of Japan

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

Speech at a Meeting with Business Leaders in Nara

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(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.

Following the discussion at the Monetary Policy Meeting (MPM) held in January 2020, 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 from fiscal 2019 through fiscal 2021.

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 the current situation for overseas economies. The Bank assesses that they have been growing moderately on the whole, although slowdowns have continued to be observed.

Downside risks concerning overseas economies seem to be still significant. However, I feel that they have eased somewhat recently, mainly reflecting progress in the U.S.-China trade negotiations and in the United Kingdom's exit from the European Union. This view seems to be shared among, for example, international organizations, as evidenced by the *World Economic Outlook (WEO) Update* released in January 2020 by the International Monetary Fund (IMF), in which the IMF assessed that the balance of risks to the global outlook remained on the downside but was less skewed toward adverse outcomes than in October.¹

In terms of the outlook for overseas economies, although it will take some time for the growth pace to pick up, they are expected to grow moderately on the whole, with the growth rates rising on the back of the materialization of the effects of macroeconomic policies in each country as well as a pick-up in the manufacturing sector, due mainly to the global cycle for IT-related goods shifting toward a phase of improvement. According to the January 2020 WEO Update, the growth rate of the global economy is projected to pick up

¹ See <https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020>.

gradually to around 3.4 percent -- about the same level as the past average -- in 2021, led by emerging economies, amid continued accommodative financial conditions.

In fact, there seem to be signs of recovery in the manufacturing sector. For example, the Global Purchasing Managers' Index (PMI) for manufacturing, which is highly correlated with world trade volume, showed signs of a pick-up, exceeding the 50 mark for the first time in seven months in November 2019; by region, the Manufacturing PMIs for the NIEs and ASEAN economies, excluding Hong Kong, also exceeded the 50 mark in December, due to the cycle for IT-related goods shifting toward a phase of improvement. I have been paying particular attention to the timing and the pace of a pick-up in overseas economies, especially in manufacturing, and my assessment is that, if these developments continue, overseas economies will pick up through the first half of 2020.

B. Japan's Economy

1. Current situation

The Bank assesses that Japan's economy has been on a moderate expanding trend, with a virtuous cycle from income to spending operating, although exports, production, and business sentiment have shown some weakness, mainly affected by the slowdown in overseas economies and natural disasters.

Looking at the December 2019 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), the diffusion index for business conditions for all industries and enterprises (the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable") remained in positive territory, as that for nonmanufacturing stayed at a favorable level reflecting an increasing trend in domestic demand, while that for manufacturing indicated a clear increase in cautiousness. The real GDP growth rate for the July-September quarter of 2019 was 1.8 percent on an annualized quarter-on-quarter basis, registering a positive figure for the fourth consecutive quarter, underpinned by domestic demand such as business fixed investment and government spending. The characteristics of the current situation -- where domestic demand underpins weak external demand, which is contrary to export-led economic expansion phases in the past -- have been maintained.

Let me elaborate on this by looking at developments by demand component.

With regard to external demand, exports, mainly of automobile-related goods and capital goods, have continued to show some weakness with the continued slowdown in overseas economies. Industrial production has decreased, partly due to the effects of natural disasters -- such as the 2019 Typhoon No. 19 -- on supply chains.

On the other hand, as for domestic demand, business fixed investment has continued on an increasing trend, with corporate profits staying at high levels on the whole. Looking at this in detail, many construction investment projects appear to aim at rejuvenating vintage building stock, such as replacement of aging existing buildings. In addition, software investment related to big data, artificial intelligence (AI), and the Internet of Things (IoT), as well as research and development (R&D) investment related to CASE, have continued to increase steadily.² Public investment also has been expanding moderately, especially for construction related to restoration and reconstruction following natural disasters as well as to national resilience. Private consumption has been increasing moderately, albeit with fluctuations due to such effects as of the October 2019 consumption tax hike, against the background of steady improvement in the employment and income situation. Meanwhile, supply-demand conditions in the labor market have remained tight, as evidenced by the unemployment rate remaining at around the lowest level observed in the current economic expansion phase, being in the range of 2.0-2.5 percent.

2. Outlook

Japan's economy is likely to continue on an expanding trend throughout the projection period -- that is, through fiscal 2021 -- as the impact of the slowdown in overseas economies on domestic demand is expected to be limited, although the effects of the slowdown are likely to remain for the time being.

Although exports likely will show some weakness for the time being in a situation where a pick-up in overseas economies is expected to take some time, they are projected to return to a moderate increasing trend with the pick-up in overseas economies. Some indicators have

² "CASE" is a term that stands for Connected, Autonomous, Shared & Services, and Electric.

started to show positive signs regarding external demand. For example, exports of IT-related goods, especially for smartphones and data centers, have turned to an increasing trend recently, and likely will maintain the firm increasing trend, partly underpinned by demand related to the introduction of 5G communication technology. Information obtained from interviews with firms in the January 2020 *Regional Economic Report* includes a view that a full-fledged recovery in exports of semiconductor manufacturing equipment to China could be expected with the improvement in the global cycle for IT-related goods.

Domestic demand is likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, mainly against the background of highly accommodative financial conditions and active government spending. Business fixed investment -- mainly construction investment related to urban redevelopment projects and that aimed at meeting inbound tourism demand, investment aimed at improving efficiency and saving labor to address labor shortage, as well as software investment and R&D investment for growth areas -- is likely to continue increasing moderately amid accommodative financial conditions, although it is expected to decelerate temporarily, mainly in machinery investment by manufacturers, due to the effects of the slowdown in overseas economies, and such factors as an accumulation of capital stock are projected to exert downward pressure from a somewhat longer-term perspective. Private consumption is expected to follow a moderate increasing trend with such effects as of the consumption tax hike waning gradually. Meanwhile, government spending is likely to increase steadily through fiscal 2020, mainly due to (1) expenditure such as for disaster-related restoration and reconstruction as well as national resilience, both of which reflect the Comprehensive Economic Measures to Create a Future with Security and Growth decided by the Cabinet in December 2019, and to (2) Olympic Games-related demand. Thereafter, it is expected to remain at a relatively high level and underpin economic activity.

Reflecting these developments in demand at home and abroad, Japan's real GDP may temporarily decline in the second half of fiscal 2019 from the first half, due mainly to the effects of the slowdown in overseas economies, the consumption tax hike, and natural disasters, but thereafter likely will see a gradual acceleration in its growth pace through

fiscal 2021. In terms of the medians of the Policy Board members' forecasts in the January 2020 Outlook Report, the real GDP growth rate is 0.8 percent for fiscal 2019, 0.9 percent for fiscal 2020, and 1.1 percent for fiscal 2021.

3. Risks to the outlook

I consider it important that domestic and external demand grow in a well-balanced manner in order to achieve sustainable economic growth. From this viewpoint, among the risks to the Bank's baseline scenario regarding the outlook for the economy, I would like to point out two to which I currently pay particular attention.

First, as for external demand, developments in overseas economies remain a risk factor. Although downside risks concerning overseas economies have decreased somewhat, mainly reflecting the progress in the U.S.-China trade negotiations, they are still significant. In particular, I think that it is necessary to pay close attention to the effects on the world economy -- including the Chinese economy -- caused by the spread of the novel coronavirus, and the impact of these downside risks on firms' and households' sentiment in Japan.

Second, turning to domestic demand, I consider that the key question is whether the moderate increasing trend in private consumption will be maintained. The effects of the consumption tax hike in October 2019 seem likely to be restrained compared with at the time of the previous tax hike in 2014, partly due to various measures implemented by the government to support households -- for example, a point reward program when using cashless payments, an increase in welfare benefits for pensioners, and the issuance of goods vouchers issued with a premium. However, I would like to closely monitor whether there will be a change in the trend in private consumption in the long run, as the effects of the decline in real income may appear gradually over time.

C. Price Developments

1. Current situation

Next, I will turn to price developments in Japan.

Regarding recent price developments, the year-on-year rate of increase in the consumer price index (CPI) for all items less fresh food has been at a level around 0.5 percent, including the effects of the consumption tax hike and policies concerning the provision of free education since October 2019, mainly because of downward pressure on prices caused by the past decline in crude oil prices and reductions in mobile-phone-related prices. There has been no change in the Bank's assessment that prices have continued to show relatively weak developments compared to the economic expansion and tight labor market conditions.

The background to why it has been taking time for prices to rise is explained in detail in the July 2018 Outlook Report.³ To explain this once again, it has been pointed out that the factors specific to Japan -- namely, the situation where the mindset and behavior based on the assumption that wages and prices will not increase easily have been deeply entrenched, due mainly to the experience of prolonged low growth and deflation -- in addition to global ones such as technological progress brought about by digitalization, have been affecting prices. It has been taking time to resolve these factors specific to Japan that have been delaying price rises, and the situation likely has continued in which the responsiveness of prices to the output gap, as well as inflation expectations that are strongly affected by the adaptive formation mechanism, do not rise easily.

Nevertheless, I hold the view that the inflation momentum has been maintained and factors that could trigger an increase in it continue to be detected.⁴ For example, housing rent is gradually turning to an increase in the CPI. The July 2018 Outlook Report that I mentioned earlier pointed out -- based on a comparison among Japan, the United States, and Germany in terms of the year-on-year rate of change in the CPI excluding food and energy for fiscal 2017 -- that the low rates of increase in administered prices and housing rent contributed significantly to the low inflation rate in Japan, which was the lowest among the three countries.⁵ The January 2020 Outlook Report pointed to the continued lackluster

³ See <https://www.boj.or.jp/en/mopo/outlook/gor1807a.pdf>.

⁴ See Masai Takako, "Economic Activity, Prices, and Monetary Policy in Japan: Speech at a Meeting with Business Leaders in Mie," Bank of Japan, September 2019.

⁵ See Box 6 "Developments in Administered Prices and Housing Rent," in the July 2018 Outlook Report. When imputed rent is included, the total share of housing rent and administered prices accounts for almost 50 percent of the CPI excluding food and energy.

developments in administered prices and housing rent as a factor delaying price rises. In this respect, housing rent has continued to make positive contributions to the CPI for Tokyo's 23 wards as a trend since around the middle of 2018 against the backdrop of the recent uptrend in land prices. On a nationwide basis, the contributions turned positive for the first time in 11 years in the CPI for November 2019. If this trend continues, housing rent will be a factor affecting the long-term trend in prices, and I am paying attention to this situation.

Turning to overseas economies, there have been active discussions regarding factors causing low inflation and policy conduct in such an environment, reflecting the continuing global phenomenon of prices not rising easily. In this situation, prices in Japan have shown somewhat different developments recently compared with those in other countries. Looking at the long-term price trends, the inflation rate has risen in Japan while it has declined in the United States and Europe.

In my view, the background to the situation where the inflation rate in Japan has been rising in general, despite the global trend of prices not rising easily, reflects in substantial part the powerful monetary easing that the Bank has been pursuing based on the joint statement with the government in January 2013.

2. Baseline scenario of the outlook for prices

With regard to the outlook for prices, the year-on-year rate of change in the CPI for all items less fresh food is likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising. The medians of the Policy Board members' forecasts of the year-on-year rate of change in the CPI for all items less fresh food presented in the January 2020 Outlook Report was 0.6 percent for fiscal 2019, 1.0 percent for fiscal 2020, and 1.4 percent for fiscal 2021.

3. Risks to prices

I now would like to talk about two points that I consider risks to the baseline scenario of the outlook for prices.

The first point is future developments in real wage growth. From a long-term perspective, wages and prices generally have moved in tandem with each other. In fact, households' tolerance toward price rises has started to increase, albeit at a moderate pace, on the back of the improvement in the employment and income situation. I consider it necessary that these positive developments further gain momentum on the back of a greater increase in real wages in order to maintain the Bank's baseline scenario.

The second point is developments in foreign exchange rates and international commodity prices. I still consider these to be risks since they not only directly affect prices but also may adversely affect business and household sentiment.

II. The Bank's Monetary Policy

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

A. Current Monetary Policy Framework

The Bank has set the price stability target at 2 percent in terms of the year-on-year rate of change in the CPI and is conducting the current framework of Quantitative and Qualitative Monetary Easing with Yield Curve Control to achieve this target at the earliest possible time. Specifically, it sets the short-term policy interest rate at minus 0.1 percent and the target level of 10-year Japanese government bond (JGB) yields at around 0 percent in the guideline for market operations, and has been taking measures such as JGB purchases to achieve the target levels. The Bank has thus supported the economic activity of firms and households by maintaining highly accommodative financial conditions.

Regarding the conduct of monetary policy, the Bank has demonstrated its stance to decide on monetary policy that is considered most appropriate, taking account of developments in economic activity and prices as well as financial conditions at the time in a comprehensive manner. In particular, since summer 2019, in a situation where downside risks to economic activity and prices, mainly regarding developments in overseas economies, have been heightening, the Bank has further clarified its intention by clearly demonstrating the policy stance of being tilted toward monetary accommodation, and has conducted monetary policy that puts a focus on strengthening its external communication. Specifically, the public

statement released after the July 2019 MPM put forth that the Bank would not hesitate to take additional easing measures if there was a greater possibility that the inflation momentum would be lost. In October, the Bank decided on a new forward guidance for the policy rates with a view to clarifying its policy stance of being further tilted toward monetary accommodation. Namely, it stated that, as for the policy rates, it expected short- and long-term interest rates to remain at their present or lower levels as long as it was necessary to pay close attention to the possibility that the momentum toward achieving the price stability target would be lost.

B. Future Conduct of Monetary Policy

At the January 2020 MPM, it was reaffirmed that the momentum toward achieving the price stability target of 2 percent was maintained but not yet sufficiently firm, and thus developments in prices continued to warrant careful attention. Specifically, downside risks to Japan's economic activity and prices stemming from overseas economies seem to be still significant, although they have decreased somewhat. As for the future conduct of monetary policy, my view is that the Bank should not hesitate to take additional easing measures if there is a greater possibility that the momentum will be lost due to materialization of these risks.

Nevertheless, accommodative financial conditions have been prolonged around the globe amid a sluggish rise in growth expectations. It therefore is natural that concerns over the risk-taking stance, mainly among firms and investors, strengthening further reflecting the continued low interest rate environment, have been recognized among, for example, international organizations.⁶ I also am aware of these concerns including a negative impact on economic activity of a decline in such rates of return as on pension products. Nonetheless, in my view, it is still indispensable that Japan persistently continues with the current policy so as to overcome deflation completely and drive sustainable economic growth. The Bank will persistently devise measures considered necessary at the time and continue to conduct monetary policy in an appropriate manner while carefully paying attention to both the positive effects and side effects of its policy.

⁶ For example, see the *Global Financial Stability Report* released by the IMF in October 2019.

III. Promotion of Women's Participation in the Economy

At a meeting with business leaders in Ehime in August 2017, I remarked that promotion of women's participation in Japan's economy was essential in terms of increasing its growth potential amid the ongoing decline in the working-age population and the worsening of labor shortages, and that one option for firms was to aim at starting a business revolution by using women's participation and advancement in the workplace as a driving force. I once again will touch upon the promotion of women's participation in the economy.

At the Group of 20 (G20) Osaka Summit in June 2019, the Leaders' Special Event on Women's Empowerment was held. At the event, it was confirmed that further efforts would be made in three priority areas -- namely, increasing women's labor participation, enhancing support for girls' and women's education, including science, technology, engineering, and mathematics (STEM) education, and engaging with women business leaders and entrepreneurs.⁷ Also, at the annual meeting of the American Economic Association in January 2020 -- where Dr. Janet L. Yellen, former chair of the Board of Governors of the Federal Reserve System, serves as president -- sessions on topics such as gender were held in a situation where voices were heard regarding a lack of diversity in the economics profession where the number of white men was disproportionately high. One of them was titled "Women in Central Banking," a panel session in which women central bankers in senior positions from the United States and Europe participated.⁸

Turning to the situation in Japan, amid this global trend, it has been taking initiatives in 12 areas, such as increasing the employment rate for women and fostering women leaders, to achieve the numerical goals by 2020 under the leadership of the Gender Equality Bureau of the Cabinet Office in accordance with the Fourth Basic Plan for Gender Equality formulated in December 2015. Achievement of the goals has come within reach with respect to some of those initiatives. For example, the latest figure for the employment rate for women between the ages of 25 to 44 years was 76.5 percent in 2018, whereas the goal is to raise the rate to

⁷ See https://www.mofa.go.jp/policy/economy/g20_summit/osaka19/pdf/special_event/en/special_event_03.pdf.

⁸ See https://www.aeaweb.org/conference/2020/preliminary/2263?q=eNqrVipOLS7OzM8LqSxIVbKqhnGVrJQMIWp1lBKLi_OTgRwIHWS1KJcXAgrJbESKpSZmwphlWWmloO0FxUUXDAFTA1AegsS01Mh5lwwXDBunx4U.

77 percent by 2020. On the other hand, it is true that there is still a gap between the ideal vision and reality with respect to some other initiatives. Specifically, the latest figure for the proportion of women board members at listed companies was 5.2 percent in 2019, while the goal is to raise the proportion to 10 percent by 2020. This may have been reflected in the latest rankings of countries in terms of the Global Gender Gap Index released by the World Economic Forum in December 2019, in which Japan ranked 121st out of the total of 153 countries -- the lowest ranking ever for Japan, down from 110th place in 2018.

Still, I feel that changes in people's perception, which is a basis for women's participation in the economy, are taking place steadily. For example, according to a survey conducted by the Cabinet Office on the proportion of people who believed that "it is better to raise boys to be masculine men and girls to be feminine women," the proportion of those who upheld that belief was 74.8 percent among women (mothers) and 78.3 percent among men (fathers) in 1972; in 2014, the figures declined to 40.4 percent and 64.1 percent, respectively. While the survey results show that women's perception regarding gender stereotypes has changed relatively significantly, they also reveal a new challenge in that the change in men's perception is relatively small, causing a perception gap between fathers and mothers. I believe that, by conscientiously dealing with each of these kinds of challenges, the empowerment of women will bring about a positive change in norms.

"Problems that currently seem impossible to solve will not necessarily remain unsolved. Sometimes, such problems can be solved through strenuous efforts, although it may take time. The important thing is to open the path toward solving problems by thoroughly providing information on successful cases." This was an observation made in an interview with Ms. Ogata Sadako, who dedicated herself to resolving refugee problems for many years as both the first woman and first Japanese person to serve as the United Nations High Commissioner for Refugees (UNHCR), and who passed away in October 2019.⁹ These words by Ms. Ogata, who was on the front line as a woman leader, appear to hold regarding the empowerment of women as well.

⁹ See <https://www.japanforunhcr.org/archives/3833/> (available in Japanese only).