February 27, 2020

Bank of Japan

Economic Activity, Prices, and Monetary Policy in Japan

Speech at a Meeting with Business Leaders in Shiga

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(English translation based on the Japanese original)

I. Economic Activity and Prices

A. Overseas Economies

I would like to start my speech by looking at developments in overseas economies.

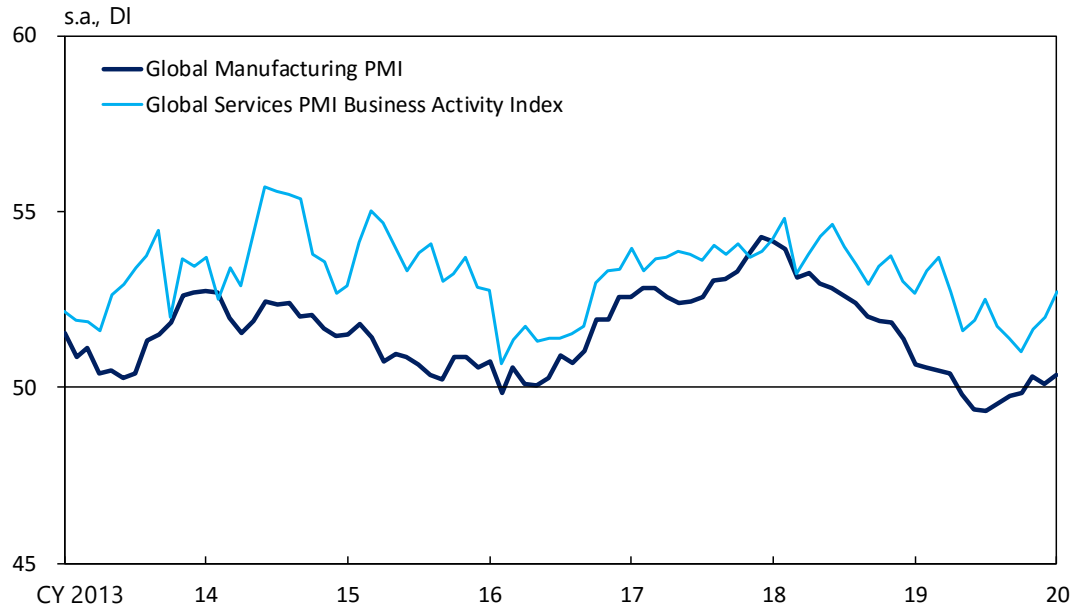
The growth pace of the global economy started to slow in the second half of 2018 and continued to slow in 2019, mainly in the manufacturing sector. According to the January 2020 *World Economic Outlook* (WEO) *Update* released by the International Monetary Fund (IMF), as presented in Chart 1, the global economic growth rate is estimated to have decelerated to 2.9 percent in 2019, and was projected to gradually pick up to around 3.5 percent from 2020. However, as seen on the right-hand side of the chart, the forecasts have been revised downward; thus, I believe that it is necessary to pay due attention to the timing and pace of recovery. Chart 2 shows the global Purchasing Managers' Index (PMI). The PMI for manufacturing climbed out of the situation where the index was below 50 -- the turning point between improvement and deterioration -- but the degree of improvement has been extremely moderate. In the meantime, although the index for services improved somewhat since the start of the year, it has been on a moderate declining trend, when fluctuations are smoothed out. The PMI as a whole has not been sufficiently firm, although there are signs of bottoming out. Looking at developments in the semiconductor market, which affect the outlook for the manufacturing sector, the year-on-year rate of change in world semiconductor shipments turned positive at the end of 2019, as shown on the left-hand side of Chart 3. According to the outlook as of November 2019, as shown on the right-hand side of the chart, the year-on-year rate of change in world semiconductor shipments is expected to recover in 2020, albeit with the degree of recovery being relatively weak compared to the 2019 decline. Thus, a shift in the cycle for IT-related goods toward an improvement phase, together with resolution of some uncertainties -- such as the signing of a U.S.-China Phase 1 trade agreement and agreement on the United Kingdom's exit from the European Union (EU) -- are factors that engender expectations for future improvement. Nevertheless, new risk factors have arisen, such as deterioration in the situation in the Middle East and the spread of coronavirus disease (COVID-19). How long these risk factors will continue and how much they will affect domestic and overseas economies on the whole is highly uncertain; therefore, it is necessary to continue to carefully assess the timing and resilience of the recovery in overseas economies without any preconceptions.

Chart 1　World Economic Outlook by the IMF

		January 2020 forecasts (y/y % chg.)			Difference from April 2018 forecasts (% pts.)		
		2019	2020	2021	2019	2020	2021
World		**2.9**	**3.3**	**3.4**	**-1.0**	**-0.5**	**-0.4**
Advanced economies	**Japan**	**1.0**	**0.7**	**0.5**	**0.1**	**0.4**	**-0.2**
	United States	2.3	2.0	1.7	-0.4	0.1	0.0
	Euro area	1.2	1.3	1.4	-0.8	-0.4	-0.1
	Germany	0.5	1.1	1.4	-1.5	-0.4	0.0
	France	1.3	1.3	1.3	-0.7	-0.5	-0.4
	United Kingdom	1.3	1.4	1.5	-0.2	-0.1	-0.1
Emerging economies	China	6.1	6.0	5.8	-0.3	-0.3	-0.2
	Brazil	1.2	2.2	2.3	-1.3	0.0	0.1
	India	4.8	5.8	6.5	-3.0	-2.1	-1.6
	Russia	1.1	1.9	2.0	-0.4	0.4	0.5

Note: For India, figures are presented on a fiscal year basis.
Source: IMF, "World Economic Outlook (January 2020, April 2018)."

Chart 2　Global PMI

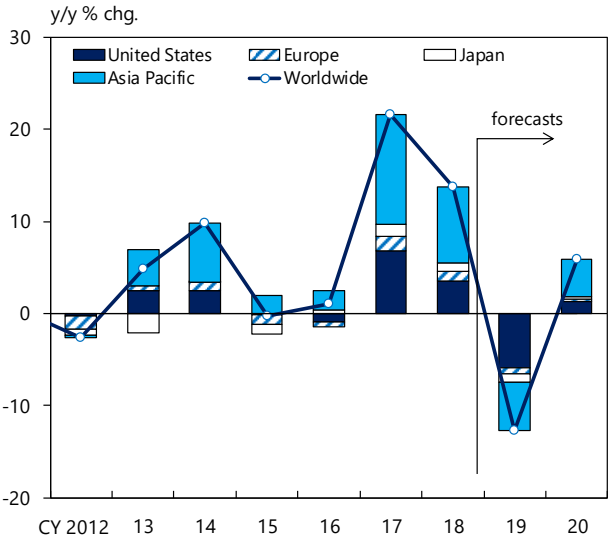


Note: Figures are from the J.P. Morgan Global PMI. Figures above 50 indicate improvement and below 50 show deterioration on a month-on-month basis. The latest figure is as of January 2020.
Source: IHS Markit (© and database right IHS Markit Ltd 2020. All rights reserved.)

Chart 3　World Semiconductor Market Forecasts

World Semiconductor Shipments

World Semiconductor Market Forecasts by Country/Region



Notes: 1. Figures are on a U.S. dollar denominated basis.
2. The latest figure in the left-hand graph is as of December 2019. In the right-hand graph, figures for CY 2019 and 2020 are forecasts made in November 2019.
Source: WSTS Inc.

Looking at developments by major country and region, in terms of the U.S. economy, while production and business fixed investment by manufacturing firms have continued to show some weakness, consumption has been firm and housing investment has been increasing, due partly to the effects of monetary easing. In Europe, although employment and wages have maintained their uptrend, the pace of increase has slowed down, albeit slightly, as recovery in the manufacturing sector has been delayed, particularly in Germany. The U.K. economy has weakened, partly due to uncertainties regarding trade relations after its exit from the EU. The Chinese economy seems to be bottoming out, as evidenced by the pick-up in indicators related to domestic demand and by an upturn in exports, both seen toward the end of 2019. With regard to the outlook, however, due attention needs to be paid to

downward pressure from the spread of COVID-19.[1] Other major economies are likely to recover moderately on the whole, but attention should continue to be paid to the possibility that the sluggishness seen in the economies of India and Hong Kong will be prolonged.

B. Japan's Economy

Next, I would like to turn to Japan's economy, starting with recent economic developments.

Chart 4 shows the trend in economic conditions in terms of three indicators released by the Cabinet Office: the leading index, the coincident index, and the *Economy Watchers Survey*'s diffusion index (DI) for current economic conditions. The DI was below 50 throughout 2018, which indicates that the majority of respondents answered that economic conditions are bad or slightly bad, and from 2019, it showed fluctuations around the time of the consumption tax hike and fell below 40. The coincident index, which shows the direction and pace of current economic developments, also has been falling since 2018. Accordingly, the assessment of the economy, which is automatically determined by the Cabinet Office on the basis of guidelines for that index's figures, was designated "worsening" for the five consecutive months since August 2019, which implies that the economy likely has been decelerating. Although the leading index is gradually leveling out, its momentum toward a pick-up is weak.[2]

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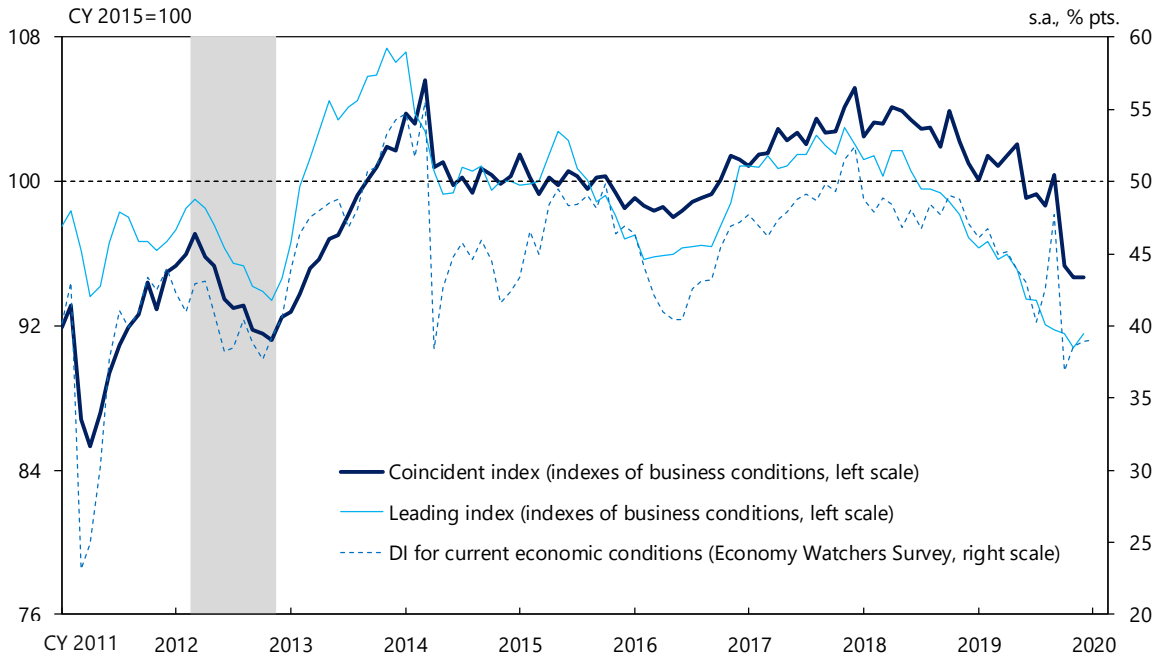
[1] Major possible effects of the COVID-19 spread on the Chinese economy -- which all result from travel restrictions and other activities -- include (1) a decline in services demand, (2) drop-offs in production, investment, and exports, (3) a drop in employment, and (4) deterioration in financial conditions. With regard to the effects of deterioration in the Chinese economy on Japan's economy, of particular concern would be decreases in exports to China, a disruption in supply chains, and a decline in inbound tourism consumption due to a fall in the number of Chinese tourists.

[2] Before the consumption tax hike in April 2014, the coincident index was continuing to increase, partly due to the front-loaded increase in demand. Before the October 2019 tax hike, however, the index was decreasing, in line with a deterioration in the basic assessment of the economy. In addition, following the 2019 hike, the index fell by 4.6 percentage points for the October-December quarter, which was larger than the 3.6 percentage point drop for the April-June quarter of 2014. It has been pointed out that these developments reflected natural disasters, among other factors, in addition to the consumption tax hike.

Chart 4 Economic Conditions in Japan

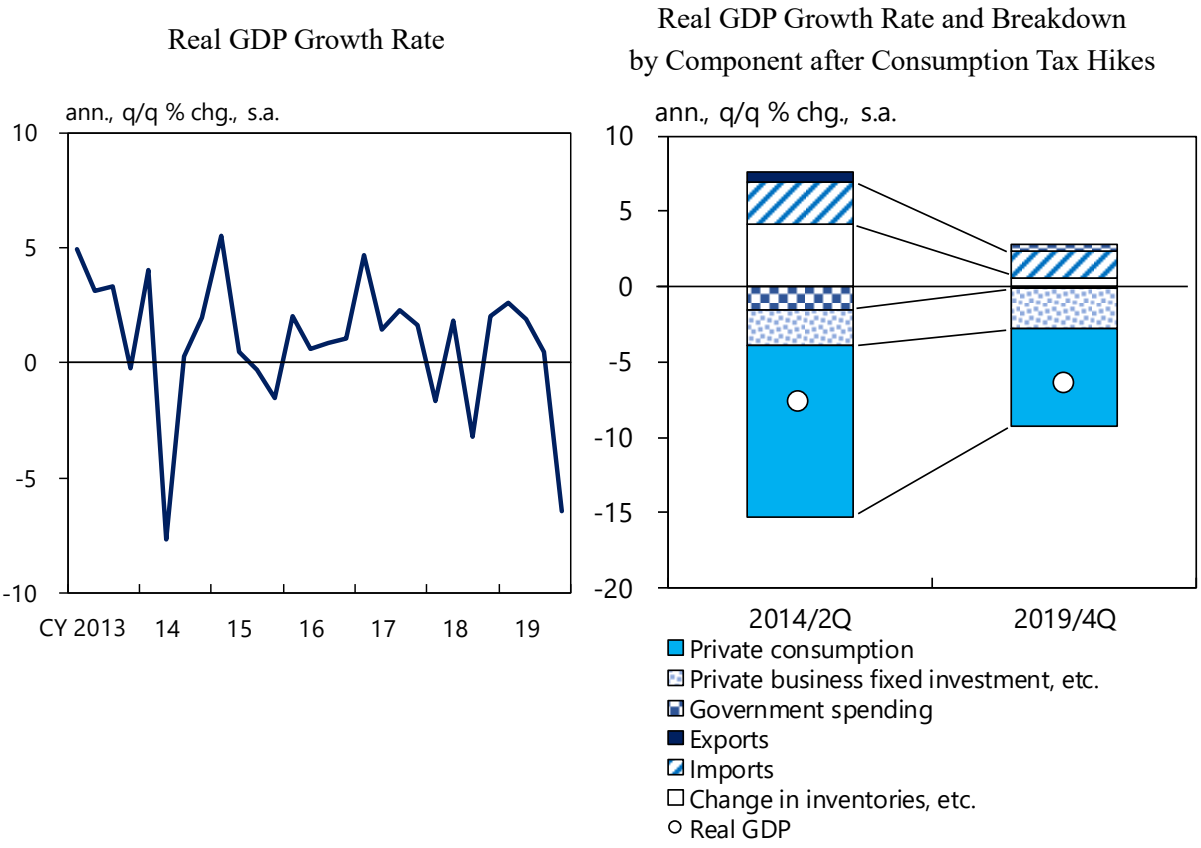


Note: The latest figures for the coincident index and leading index are as of December 2019, and the latest one for the DI for current economic conditions is as of January 2020.
Sources: Cabinet Office, "Indexes of Business Conditions," "Economy Watchers Survey."

Next, I will touch on Japan's economic developments by looking at real GDP growth rates, as shown in the left-hand side of Chart 5. The preliminary estimate of the real GDP growth rate for the October-December quarter of 2019 on an annualized quarter-on-quarter basis was minus 6.3 percent, the largest negative figure recorded after the April-June quarter of 2014. Domestic demand -- such as private consumption, housing investment, and business fixed investment -- declined due to the effects of both the consumption tax hike and natural disasters. In the meantime, exports continued to decline, reflecting sluggishness in overseas economies. The right-hand side of Chart 5 compares the October-December quarter of 2019 with the April-June quarter of 2014 -- when the consumption tax was raised from 5 percent to 8 percent -- in terms of the real GDP growth rate and the contribution of demand components by item. Last year's decline in consumption also was marginal compared with 2014, with the tax rate increase in 2019 being smaller than in 2014 and with a reduced tax

rate being applied to some consumer items.[3] Meanwhile, although public demand increased, business fixed investment showed a significant decline -- larger than in 2014 -- and exports also exerted downward pressure.

Chart 5 Real GDP Growth



Source: Cabinet Office, "Quarterly Estimates of GDP for October-December 2019 (First Preliminary Estimates)."

Turning to the outlook for Japan's economy, as shown in Chart 6, the medians of the Bank of Japan Policy Board members' forecasts for the real GDP growth rates presented in the January 2020 *Outlook for Economic Activity and Prices* (Outlook Report) are 0.8 percent for fiscal 2019, 0.9 percent for fiscal 2020, and 1.1 percent for fiscal 2021. The Bank's baseline scenario is that, from 2020, although Japan's private consumption, business fixed

[3] The quarter-on-quarter rate of change in private consumption was minus 2.9 percent for the October-December quarter of 2019, which was a smaller decline compared to minus 4.8 percent for the April-June quarter of 2014, but larger than minus 2.5 percent recorded in the April-June quarter of 1997 when the tax rate was raised from 3 percent to 5 percent. Therefore, it could be said that the decline in 2019 was serious.

investment, and exports could decline at some point, the economy is likely to be solid when fluctuations are smoothed out amid moderate overall growth in overseas economies. However, risks to the above outlook are tilted to the downside, as described in the Outlook Report, and I am of the view that future economic activity needs to be assessed more carefully.

Chart 6　Outlook for Economic Activity and Prices (January 2020 Outlook Report)

medians of Policy Board members' forecasts, y/y % chg.

	Real GDP	CPI (all items less fresh food)	(Reference) Excluding the effects of the consumption tax hike and policies concerning the provision of free education
Fiscal 2019	+0.8	+0.6	+0.4
Forecasts made in October 2019	+0.6	+0.7	+0.5
Fiscal 2020	+0.9	+1.0	+0.9
Forecasts made in October 2019	+0.7	+1.1	+1.0
Fiscal 2021	+1.1	+1.4	
Forecasts made in October 2019	+1.0	+1.5	

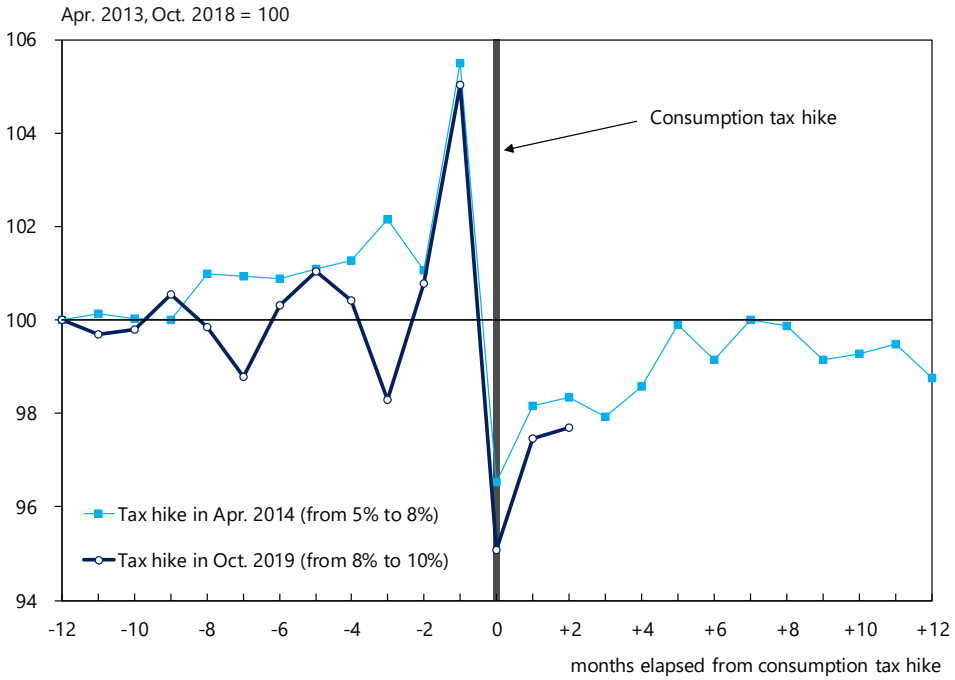
Note: The direct effect of the consumption tax hike on the CPI for fiscal 2019 and fiscal 2020 is estimated to be 0.5 percentage point for each year. The direct effects of policies concerning the provision of free education on the CPI for fiscal 2019 and fiscal 2020 are estimated to be minus 0.3 percentage point and minus 0.4 percentage point, respectively.
Source: Bank of Japan, "Outlook for Economic Activity and Prices (January 2020)."

Starting with private consumption, Chart 7 compares developments in consumption before and after the tax hikes in October 2019 and April 2014, using the consumption activity index (CAI). The chart shows that the pace of expansion in consumption during the period ranging from eight months to three months prior to the 2019 hike was slower than in 2014. Nevertheless, I would like to point out that consumption for the one month period prior to the 2019 hike gained as much momentum as it did in 2014, and that its decline following the 2019 hike -- even with the effects of natural disasters -- was on a par with the decline

after the 2014 hike.[4] Looking at Chart 8, which shows developments in the employment situation and in consumer sentiment -- both of which underpin private consumption -- the employment-related level DI in the *Economy Watchers Survey* has continued to track below the neutral point of 50 since July 2019, and the number of active job openings on a year-on-year basis has been negative for 10 consecutive months. In the meantime, compared with the 2014 tax hike, consumer sentiment had already been at lower levels since before the 2019 hike, and its degree of recovery after the hike has been smaller. In addition, if it takes time to eradicate COVID-19 in Japan, there are concerns that consumption will be pushed down as consumers refrain from going out or traveling, and as their sentiment deteriorates. Therefore, I believe it is necessary to keep in mind the possibility that the underlying trend in private consumption will weaken further, reflecting such developments as adjustments in the labor market as well as the deterioration in consumer sentiment against the background of the consumption tax hike.

[4] Akutsu and Koike explain that weather variation accounts for about 20 to 30 percent of the monthly fluctuations in the CAI. This is confirmed by the results of the variance decomposition of the index, which is conducted based on a vector auto regression (VAR) model estimated using seven variables -- (1) precipitation, (2) summer temperature, (3) winter temperature, (4) the seasonally adjusted month-on-month rate of change in fresh food prices, (5) the month-on-month rate of change in stock prices, (6) the seasonally adjusted month-on-month rate of change in real employee income, and (7) the seasonally adjusted month-on-month rate of change in the CAI (real, travel balance adjusted). For details, see Akutsu, K. and Koike, Y., "Analysis of Private Consumption Using Weather Data," *Bank of Japan Review Series*, no. 2019-E-1, April 2019, https://www.boj.or.jp/en/research/wps_rev/rev_2019/data/rev19e01.pdf.
Nakazato argues that the results of an empirical study show that developments in real income and stock prices had a statistically significant impact on sales at department stores, but that weather had only limited effects on those sales. For details, see Nakazato, T., "'Tenkō fujyun' no keizai bunseki: shōhizōzei go no shōhi dōkō," *Economic Research Society of Sophia University Discussion Paper Series*, no. J17-2, February 2018.

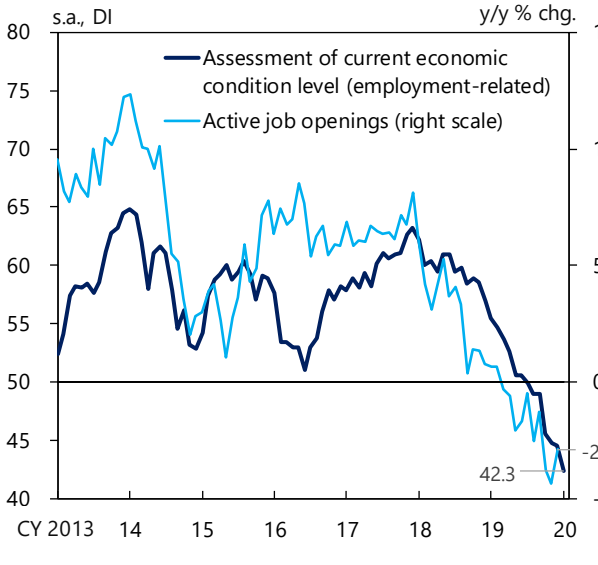
Chart 7　Consumption before and after Consumption Tax Hikes



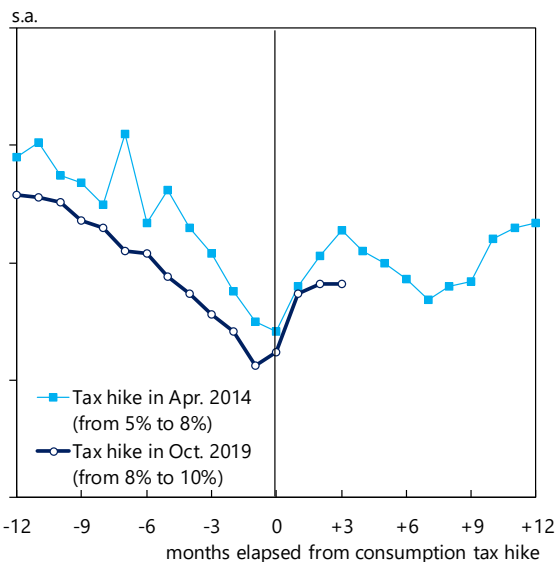
Source: Bank of Japan, "Consumption Activity Index."

Chart 8　Household Consumption

Employment-Related Indicators



Consumer Confidence Index before and after Consumption Tax Hikes

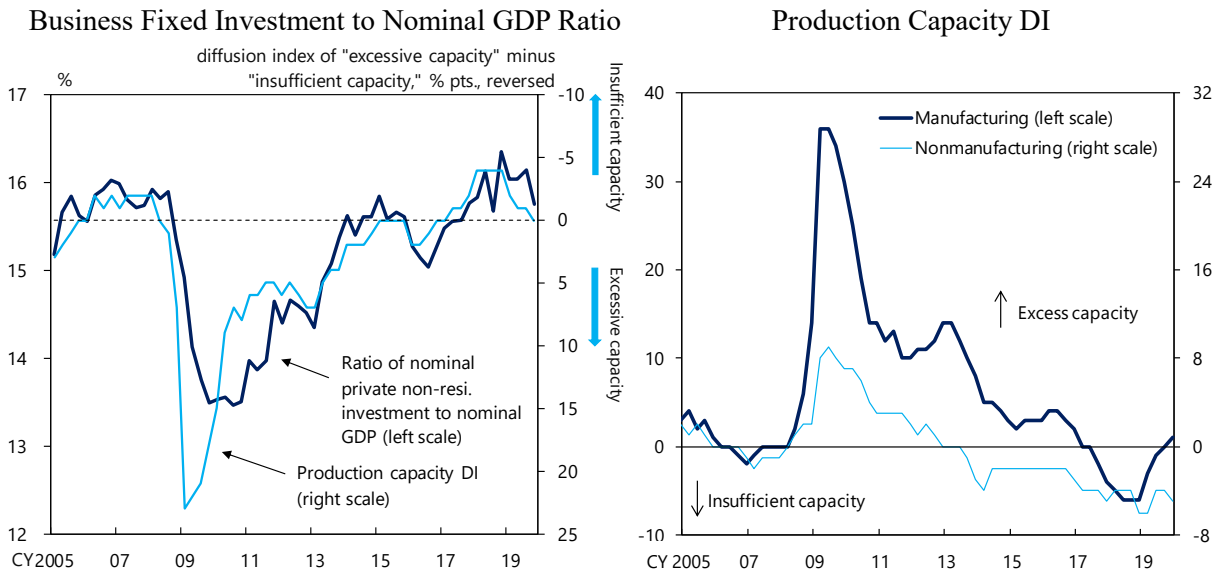


Notes: 1. In the left-hand graph, the latest figures are as of December 2019 for active job openings and January 2020 for assessment of current economic condition level (employment-related).
2. Households with two or more persons are counted in the right-hand graph.

Sources: Cabinet Office, "Economy Watchers Survey," "Consumer Confidence Survey"; Ministry of Health, Labour, and Welfare, "Employment Referrals for General Workers."

Second, as for business fixed investment, the increasing trend of the ratio of business fixed investment to nominal GDP has entered a hiatus recently, as shown in Chart 9. I am of the view that this is attributable to an easing of shortages in production equipment and facilities as perceived by firms, mainly in the manufacturing sector, as well as to the reactionary decline in demand after the consumption tax hike.[5] The expansion in business fixed investment in recent years has been underpinned by research and development (R&D) investment and software investment reflecting labor shortages. However, deterioration in business sentiment in some industries, including the automobile and retailing industries, which are the major initiators of these investments, could negatively affect the outlook for the overall business fixed investment in Japan, with a certain time lag.

Chart 9 Business Fixed Investment



Note: Production capacity DI in the left-side chart shows figures for large enterprises of all industries. The right-side chart shows figures for enterprises of all sizes.
Sources: Cabinet Office, "Quarterly Estimates of GDP for October-December 2019 (First Preliminary Estimates) "; Bank of Japan, "Tankan (Short-Term Economic Survey of Enterprises in Japan)."

[5] It is considered that there were effects of (1) dissipation of the increase in demand for business fixed investment to handle the reduced tax rate and cashless payments, (2) a decline following the front-loaded increase among some small firms that are eligible for the simplified tax system or the tax exemption, and (3) a peaking out of replacement demand for personal computers due to the expiration of support for a particular operating system.

Lastly, the momentum in real exports, particularly exports to Asian economies and the United States, also has been sluggish since 2019, as shown in Chart 10. Given the significant uncertainties regarding the timing and degree of recovery in overseas economies, my view is that, for the time being, it is highly likely to continue to be difficult to hold out high expectations for a recovery in exports.

Chart 10　Real Exports

y/y % chg.　　s.a., q/q % chg.　　s.a., m/m % chg.

	CY		2018	2019				2019		
	2018	2019	Q4	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.
United States	2.3	1.5	4.1	0.3	4.6	-5.3	-7.9	-0.4	-3.9	-0.8
EU	6.1	0.7	2.9	2.0	-3.5	5.3	-6.8	-4.4	-1.7	3.0
Asia	3.2	-3.1	-0.6	-3.2	0.5	0.9	1.6	-2.2	3.0	0.2
China	5.9	-3.4	-0.5	-5.5	1.6	0.8	4.4	-0.2	2.0	3.5
NIEs, ASEAN, etc.	1.7	-2.9	-0.8	-1.9	-0.2	1.1	-0.1	-3.8	3.9	-1.9
Others	3.5	-2.7	2.8	-3.0	-2.6	10.0	-3.1	4.5	-9.7	4.4
Real exports	2.2	-2.1	0.5	-1.7	0.1	1.8	-2.2	-1.6	-1.7	1.8

Source: Bank of Japan, "Developments in Real Exports and Real Imports."

C. Recent Developments and Outlook for Prices

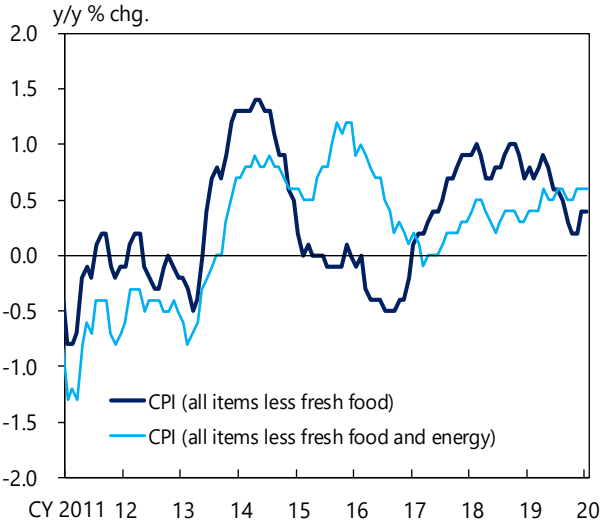
Next, I will move on to price developments.

The observed year-on-year rates of increase in the consumer price index (CPI) for January 2020 were 0.8 percent for all items less fresh food and also 0.8 percent for all items less fresh food and energy. As shown on the left-hand side of Chart 11, the inflation rate excluding the effects of the consumption tax hike remains well below the price stability target of 2 percent. On the right-hand side of the chart, the indicators that represent

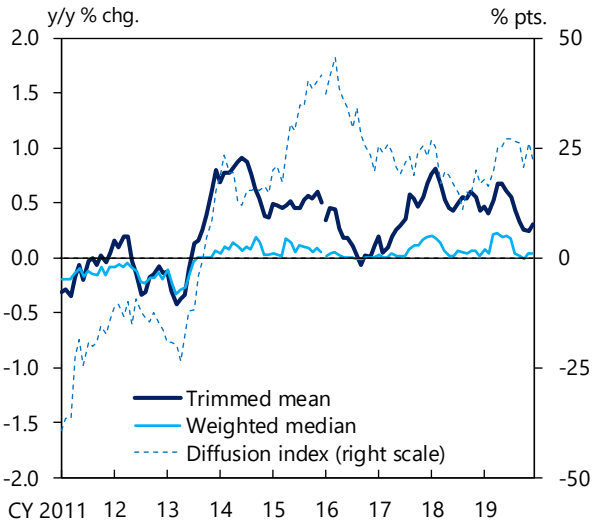
underlying changes in consumer prices also have continued to show relatively weak developments.[6]

Chart 11 Consumer Prices

Consumer Price Index



Underlying Developments in Consumer Prices



Notes: 1. In the left-hand graph, figures are adjusted for changes in the consumption tax rate.
2. In the right-hand graph, the diffusion index is defined as the share of increasing items minus that of decreasing items. The share of increasing/decreasing items is the share of items in the CPI (less fresh food, consumption tax adjusted), for which the price increased/decreased from a year earlier.

Source: Ministry of Internal Affairs and Communications, "Consumer Price Index"; Bank of Japan, "Measures of Underlying Inflation."

Turning to the outlook for prices, according to the medians of the Policy Board members' forecasts presented in the January 2020 Outlook Report, the year-on-year rate of change in the CPI (all items less fresh food) is expected to increase gradually from 0.6 percent for fiscal 2019 to 1.0 percent for fiscal 2020, and to 1.4 percent for fiscal 2021, as shown in Chart 6. On this point, the Bank's view is that the momentum toward achieving the 2 percent price stability target is maintained but is not yet sufficiently firm, and thus developments in prices continue to warrant careful attention. I dissented from the relevant description in the Outlook Report, however, as I judged that the momentum had already

[6] All the indicators shown in Chart 11 have either declined or stayed flat since the middle of 2019, and signs of a rise in the underlying trend in prices have not been observed.

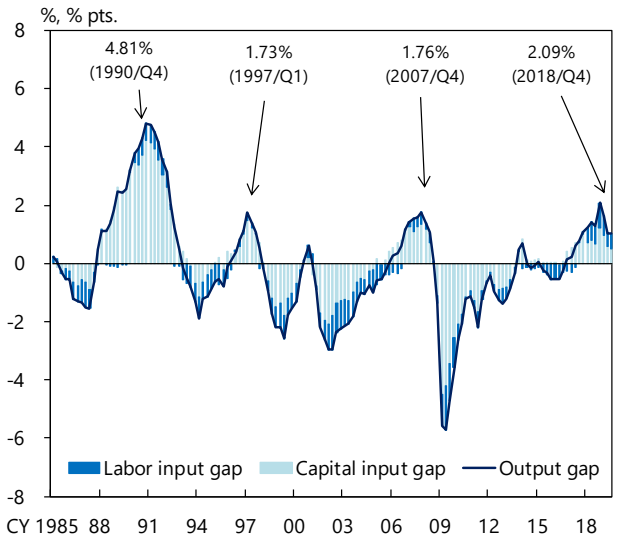
been lost, and that the possibility of the inflation rate increasing toward 2 percent was low at that moment.

As for the outlook for and the momentum of prices, it is important to consider -- in addition to the observed inflation rate mentioned earlier -- developments in the output gap and in medium- to long-term inflation expectations, which are indicators that influence underlying price developments, as well as the mechanism through which they affect the inflation rate. The output gap, as shown on the left-hand side of Chart 12, has remained positive, reflecting improvements in the capital stock and labor markets.[7] Since it peaked in the October-December quarter of 2018, however, the output gap is no longer on an expanding trend. Meanwhile, inflation expectations have continued to be somewhat weak, as indicated on the right-hand side of the chart.

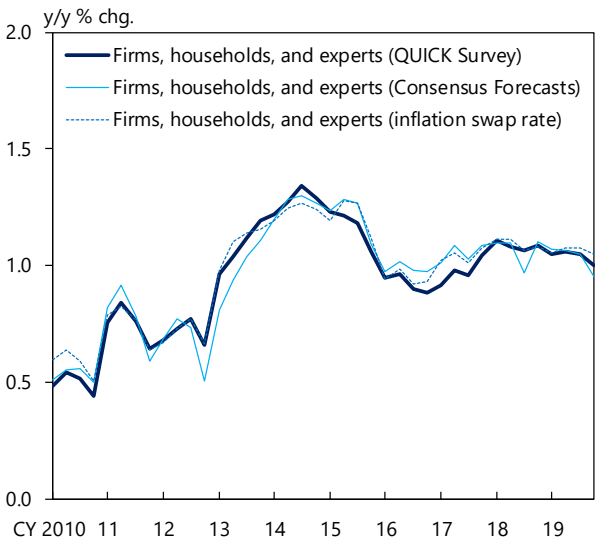
[7] Data on the output gap need to be viewed with some latitude as the estimates may differ considerably depending on the estimation methods, and also as they are subject to estimation errors. Ishida and Nakazawa estimate the output gap using the production-function approach while referring to the estimation method by the Cabinet Office and other institutions. The estimate can generate errors of around 1.6 percentage points with a 95 percent confidence interval. In particular, when the positive output gap is shrinking, it is necessary to assess the effects of the output gap on prices more carefully, taking into account other indicators as well. For details, see Ishida, R. and Nakazawa, M., "GDP gyappu no suikei gosa no hyōka," *KIER Discussion Paper Series*, no. 1204, July 2012.

Chart 12 Output Gap and Inflation Expectations

Output Gap



Synthetic Indicators of Inflation Expectations



Notes: 1. The data for the output gap in the left-hand graph are the estimates by the Bank's staff as of January 8, 2020.

2. In the right-hand graph, synthetic inflation expectations indicators are obtained by synthesizing expectations of firms, households, and experts using the principal component analysis.

3. Firms' inflation expectations are taken from the *Tankan* (using the output prices DI). Figures for households are taken from the *Opinion Survey on the General Public's Views and Behavior* (using the average of inflation expectations over the next five years excluding those respondents who have annual inflation expectations of ±5% or more). For experts' inflation expectations, three different types of data are used: the *QUICK Survey* (average over the next 10 years), the *Consensus Forecasts* (average for 6-10 years ahead), and the inflation swap rate (5-year, 5-year forward).

Sources: Consensus Economics Inc., "Consensus Forecasts"; QUICK Corp., "QUICK Monthly Market Survey (Bonds)"; Bloomberg; Bank of Japan.

In my view, there are three important factors to consider regarding the mechanism through which the output gap and inflation expectations affect future inflation rates. First, a widening of the output gap is less likely to lead to a rise in inflation rates. Second, it is likely to take considerable time for the adaptive expectation formation mechanism to bring about an increase in inflation expectations, which may then lead to price rises. Third, in a situation where monetary policy is adjusted only slightly amid successive downward revisions to the Bank's outlook for prices, it is unlikely that an enhancement of the credibility of monetary policy will cause inflation expectations to rise ahead of actual prices.

In view of the current situation, in which the output gap and inflation expectations are not improving, and of the possibility that the mechanism through which they bring about a rise in the inflation rate is not strong, it is difficult at this point to expect that the inflation rate will climb toward 2 percent, and in my opinion, it cannot be claimed that the momentum toward achieving the price stability target has been maintained.

II. Conduct of Monetary Policy

Let me first outline the Bank's current monetary policy, based on the outlook for economic activity and prices that I have described. I would then like to express my opinion about the Bank's monetary policy conduct.

A. Outline of the Current Monetary Policy

The Bank conducts monetary policy under the framework of Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, aiming to achieve the 2 percent price stability target. This current framework consists of three major components (Chart 13).

Chart 13 Outline of the Bank's Monetary Policy

(1) Yield Curve Control

Short-term rate: The Bank will apply minus 0.1 percent to the Policy-Rate Balances.

Long-term rate: The Bank will purchase JGBs so that 10-year JGB yields will remain at around zero percent. While doing so, the yields may move upward or downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

(2) Asset Purchases

The Bank will purchase ETFs and J-REITs so that their amounts outstanding will increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions.

(3) Commitment

Overshooting commitment: The Bank 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.

Forward guidance for policy rates: The Bank expects short- and long-term interest rates to remain at their present or lower levels as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost.

The first is yield curve control, in which the Bank sets the short-term policy interest rate at minus 0.1 percent and the operating target for long-term interest rates at around 0 percent. As for long-term interest rates, the Bank purchases Japanese government bonds (JGBs) while allowing some degree of fluctuation in long-term yields, depending mainly on developments in economic activity and prices.

The second component is the purchase of risk assets, including exchange-traded funds (ETFs). The Bank's guideline is to purchase ETFs so that their amount outstanding will increase at an annual pace of about 6 trillion yen. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions.

The third component is the Bank's public commitment regarding the future conduct of monetary policy. The commitment mainly consists of the inflation-overshooting commitment -- under which the Bank will continue expanding the monetary base until the inflation rate exceeds 2 percent and stays above this target in a stable manner -- and forward guidance -- which is the Bank's guideline for its future policy rates. The Bank revised its forward guidance in October 2019, and expressed that it "expects short- and long-term interest rates to remain at their present or lower levels as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost." The Bank currently conducts monetary policy while remaining attentive to the necessity of easing; it intends to introduce additional easing measures without hesitation when necessary. By making this stance clearer, the Bank revised its forward guidance with an aim to gain credibility with markets and the public regarding its attitude toward monetary easing.

B. My Personal View on the Conduct of Monetary Policy

Of these three components, I dissented from two: yield curve control and the Bank's commitment regarding the future conduct of monetary policy. Based on my assessment that the momentum toward the 2 percent price stability target has been lost, I believe it is appropriate to introduce a measure that will improve the output gap and increase inflation expectations.

As for yield curve control, I am of the view that it is appropriate to make the shape of the yield curve more accommodative -- by setting a greater negative value for the short-term policy interest rate -- and to encourage a further widening of the output gap within positive territory. As presented in the joint statement by the Bank and the government, the Bank's mission is to achieve the price stability target at the earliest possible time. With this in mind, in the current situation where the observed inflation rate is evidently far from the 2 percent price stability target, I believe that my view holds true.

As a means to increase inflation expectations, I consider that it will be effective to strengthen the Bank's commitment regarding the future conduct of monetary policy. I am concerned about the current commitment, insofar as the condition of "as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost" attached to the forward guidance may not be sufficiently specific, and will most likely fail to gain enough confidence as a means to exert additional positive impact on inflation expectations. I believe that the effectiveness on inflation expectations will be strengthened by revising the forward guidance to offer a stronger commitment; for example, by setting conditions with regard to the gap between the 2 percent price stability target and the observed inflation rate, and promising that specific actions will be taken when the gap widens beyond a certain threshold.

Lately, the term "Japanification" of advanced economies is being used frequently.[8] The continued stagnation of aggregate demand combined with low growth, low inflation, and low interest rates pushes down a country's potential growth rate. This vicious cycle then becomes prolonged and firmly fixed, leading to even lower growth, lower inflation, and lower interest rates. This is exactly how the long-term stagnation of Japan's economy from

[8] At the American Economic Association's 2020 annual meeting held in San Diego, California, there was a session titled "Japanification, Secular Stagnation, and Fiscal and Monetary Policy Challenges." For details, see https://www.aeaweb.org/webcasts/2020/japanification-secular-stagnation-fiscal-monetary-policy-challenges.

the 1990s evolved.[9] Since 2013, with the launch of the so-called "Abenomics" policies, coupled with the Bank's bold monetary easing measures, employment has improved significantly and prices have not experienced deflation, which represents great progress. However, Japan's economy has still not been able to completely eliminate the condition of low growth, low inflation, and low interest rates.

In my opinion, for the economy to completely move out of the current situation of low growth, low inflation, and low interest rates, it is particularly important to consider the dimension of sustained coordination between the government and the Bank regarding economic policy (Chart 14). If the government implements flexible fiscal measures while the Bank strengthens its bold monetary easing measures, the synergy between the monetary and fiscal policies will produce stronger stimulus effects on the economy than when each policy is implemented independently. Growth policy also strengthens the effectiveness of macroeconomic policies in the long run, by raising the growth expectations of firms and households and increasing the natural rate of interest. Thus, I believe that the continued functioning of all the economic policies in such a coordinated manner can be a driving force to help the economy move out of the situation of low growth, low inflation, and low interest rates.[10] Given this point, I consider that it will most likely be beneficial to reevaluate the effectiveness of the Bank's monetary policy, including the interaction among fiscal, monetary, and growth policies, and to review its framework.

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[9] For a recent examination and analysis of Japan's economy covering the evolution of the long-term stagnation from the 1990s up to the present situation, see, for example, Tsuru, K., Maeda, S., and Murata, K., *Nihon Keizai no Makuro Bunseki: Teion Keizai no Pazuru o Toku*, (Tokyo: Nikkei Publishing Inc., 2019).

[10] Tashiro analyzes the cause of Japan's economy having fallen into prolonged stagnation, and argues that, in addition to increasing expectations for expansion in aggregate demand by utilizing monetary and fiscal policies, improvement in growth expectations through a constant increase in income is necessary for Japan's economy to move out of stagnation. For details, see Tashiro, T., *Nihon Keizai Saigo no Senryaku: Saimu to Seichō no Jirenma o Koete* (Tokyo: Nikkei Publishing Inc., 2017).

Chart 14 Transmission of Policy Coordination