

BOJ Governor Kuroda's Press Conference December 21, 2017

G: BOJ Governor Kuroda

Q: Reporters

Q: From Yomiuri, the managing news company for December. First, the Policy Meeting seemed to have ended earlier than usual, please tell us what was decided at the policy meeting today and also the overview of the economy and prices of Japan and the world, which was behind the decision today.

G: At the Monetary Policy Meeting held today, we decided to maintain the existing policy for monetary market adjustments under the long- and short-term rates manipulation, or so-called "Yield Curve Control," as before, by a majority vote. That is, in terms of the short-term interest rate, the Bank will apply a negative interest rate of minus 0.1% to the Policy-Rate Balances in current accounts held by financial institutions at the BOJ, and, at the same time, in terms of the long-term interest rate, the Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain at around zero percent. In addition, with regard to asset purchases other than JGBs, we have decided unanimously to continue the current purchase policy. With respect to the current situation of the Japan's economy, we judged that the economy is expanding moderately, with a virtuous cycle from income to spending operating. To provide a little more detail, overseas economies have continued to grow at a moderate pace on the whole. On the domestic demand side, business fixed investment has continued on an increasing trend with corporate profits and business sentiment improving. Private consumption has been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. Housing investment has been more or less flat. Meanwhile, public investment has been more or less flat, remaining at a relatively high level. Reflecting these increases in demand both at home and abroad, industrial production has been on an increasing trend, and labor market conditions have continued to tighten steadily. Financial conditions are highly accommodative.

With regard to the outlook, Japan's economy is likely to continue its moderate expansion. 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, on the back of highly accommodative financial conditions and underpinnings through the government's past stimulus measures. Exports are expected to continue their moderate increasing trend on the back of the growth in overseas economies.

On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is in the range of 0.5-1.0 percent. Inflation expectations have remained in a weakening phase.

The year-on-year rate of change in the CPI is likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations.

Risks to the outlook include the following: the U.S. economic policies and their impact on global financial markets; developments in emerging and commodity-exporting economies; negotiations on the United Kingdom's exit from the European Union (EU) and their effects; prospects regarding the European debt problem, including the financial sector; and geopolitical risks.

The BOJ will continue with "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," aiming to achieve the price stability target of 2%, as long as necessary for maintaining the target in a stable manner. In addition, the Bank will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items excluding fresh foods) exceeds 2% and stays above the target in a stable manner. The Bank will make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target.

Second question. As shown in the Tankan survey released the other day, the problem of labor shortages has been more serious these days. Labor shortage has both good and bad sides. Would you please tell us your opinion regarding its impact on the economy?

G: As you pointed out, and also, as the BOJ Tankan survey released the other day has shown, it is true that the supply-demand of labor in Japan has been increasingly tight as the economy continues to expand. I understand that some say that the seriousness of labor shortage, especially in the labor-intensive sector, may be a constraint on the development of business. However, many companies are responding to the labor shortage by utilizing a wide variety of human resources including senior citizens and female workers, as well as adopting various working systems, or they try to invest aggressively in labor-saving measures. They are very active in making various efforts. Therefore, labor shortage will not be the constraint to the economic expansion as far as the economy as a whole is concerned. In the first place, seen from a rather long-term perspective, against the backdrop of the rapidly shrinking working population, in order to keep economic development in a sustainable manner, it is essential for companies to keep up efforts to improve productivity. The labor shortage these days may inadvertently push up the efforts. In this regard, the government is trying various structural reform efforts, including "Work Style Reform" aimed at improving labor productivity. We expect that the proactive efforts of companies will lead to strengthening the Japanese economy.

Q: The third question. Today's meeting is the last policy meeting this year. In terms of monetary policy, this year saw a series of decisions to maintain the status quo. Looking back, how do you describe this year? About next year, what will become of the Japanese economy and the world economy? What is your opinion right now?

G: Surely, looking back on this year, there was certainly a significant increase in trade volume in the world, and the business sentiment in the manufacturing sector improved globally. We saw a balanced development across all regions. Partly supported by the recovery of the world economy, the economy of Japan has improved steadily. There was a broad recovery, in terms of regions and sectors, I mean the recovery was not limited to certain sectors or regions. The recovery has spread broadly over the whole economy. Regarding the future, I believe overseas economies will continue to expand moderately. In addition to the steady growth of developed countries, the ripple effect of their good economies and also the effects of policies taken in various countries support the solid recovery of emerging countries. We see moderate expansion of the Japan's economy continuing against a backdrop of expansion of overseas economies and the very accommodative monetary conditions, while there will be continuation of the virtuous cycle from income to spending both in corporate and household sectors.

On the other hand, regarding the prices, while the year-on-year increase in the consumer prices has been gradually widening over the past year, it is certainly still weaker than the tight situation of labor supply-demand, or the economic expansion. However, recently, amid the steady improvement in the macro supply-demand situation, the hourly wages for part-time workers are clearly on an upward trend. Whole sale prices increased due to the weaker yen. So, from the perspective of corporate costs, the upward pressure for the prices has been steadily increasing. While the employment and income situations have been recovering, the tolerance of the consumers for higher prices has been increasing. Under these circumstances, it can be expected that the wage-setting stance of companies will be increasingly positive. In addition, as the prices actually go up, the medium-to-long-term price expectations are expected to rise hand in hand. So, the year-on-year increase in the prices will continue to rise into next year.

These are the main scenario. As shown in the statement, we also have risks, especially around the overseas economies. Basically, I think the steady growth in 2017 will continue in 2018.

Q: Thank you very much. The questions from the managing company are now over. Shall we continue with other questions?

Q: (Tsujiura from Kyodo Tsushin) I have two questions. The first. The other day in Zurich in Switzerland you used the term 'reversal rate' and recently both you and the Deputy Governor have talked about regional institutions and the increase in the limits being reached for financial intermediation. So, is there any particular reason for introducing this new term at this point in time? Please tell us the back story for such a comment. In the past, I believe you have said that you are not undertaking monetary policy for the benefit of financial institutions. What has changed? I would

appreciate if you could tell us what has made you want to use this term and if there is anything specific about the current environment that has brought this about? The second question which relates to the first. The profits of regional financial institutions have deteriorated considerably at present, so I would appreciate if you would comment on that situation. Thank you.

G: As you have noted, the idea behind this 'reversal rate' is that if interest rates fall too far the financial intermediation function is impaired, so that the effects of monetary easing are reversed. This is one academic theory. This is in fact a very interesting analysis. Presently in Japan, financial institutions have sufficient capital and the cost of capital has substantially declined, so I believe there is no problem with financial intermediation at the present point in time. Looking at various surveys such as the Tankan (BOJ Short-term Economic Survey of Enterprises in Japan), the lending attitude of financial institutions remains positive even under the low interest rate environment, and loans outstanding are also rising steadily. The thinking about the formation of the yield curve under this Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control was already clarified at the time of the Comprehensive Assessment conducted in September last year. The decision was made to form a comprehensive and appropriate yield curve taking account of developments in economic activity and prices as well as financial conditions in relation to the impact on the spread of loan rates and corporate bond yields, the impact on the economy, and the impact on financial function etc. That was the thinking behind the introduction of the Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control in September last year and this has not changed at all since then. Even though I made a reference to this reversal rate, which is an academic analysis, that has no particular significance to suggest there is a possible need to revise the Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control that was introduced in September last year. I also spoke at the University of Zurich, and in providing an explanation that was easy for foreigners to understand about the new framework for Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control that was introduced taking account of the Comprehensive Assessment, I also referred to various examples of academic theories not just this reversal rate. This does not mean there has been any change.

In relation to your second question about the problem of regional financial institutions, as noted in the recently released Financial System Report from the BOJ that provides considerable detail, the profits of regional financial institutions have deteriorated considerably under the recent low interest rate environment. But more than this, as actually analyzed in detail in the Financial System Report, there has been structural decline in population and the number of companies in regional areas over a very long period of time, so it is highly likely that the numbers of employees and branches tend to be excessive. Under such circumstances, capabilities of regional financial institutions to provide non-interest services attached to loans are limited, so there is inevitably less differentiation in loan products, so the competition based on the level of interest rates tends to heat up. So, reportedly this in part reflects the so-called structural change in Japan. So, how to deal with this, and how to

continue providing an environment for regional financial institutions where there can be appropriate financial intermediation is also addressed in the Financial System Report. Each financial institution needs to make better use of the unique strength of the particular region to differentiate its products when providing financial services. On the other hand, in terms of efficiencies, it is also important to improve efficiencies in various areas. At any rate, the BOJ will continue to monitor the permissible profitability of financial institutions or business reform initiatives through supervision and monitoring to ensure such initiatives and to provide support.

Q: (Takami of Nikkei Shimbun) I would like to ask about Basel III. Japan's views appear to have been taken into consideration in relation to the bank risk-asset assessment including the issue of sovereign risk assessment and I would appreciate your views on the situation. I also presume you met with the relevant Central Bank Governors and would appreciate if you would explain the role of the BOJ Governor in such international negotiations. I believe this also relates to the qualities of the next BOJ Governor and would appreciate hearing your thoughts.

G: We are very pleased to have reached the final stages of Basel III. Various financial regulations have been decided over a very long period following the Lehman shock, and we have finally reached agreement on this one remaining matter. Consequently, the operation to revise international financial regulation was concluded. In other words, in terms of regulation, the uncertainty about what types of new regulations will appear has been eliminated. It has become clear, so this agreement should be welcomed very much. In future, in accordance with this agreement, there are a number of steps and it is important to implement them properly. In international terms, this will be considered, and there is likely to be a shift to a phase of checking whether the implementation of such measures actually produces the desired effect. There was some discussion about sovereigns as well and there was absolutely no consensus in relation to the need to revise the regulations for international sovereigns and the consideration of such matter came to an end. So, the conclusion was the current regulation on sovereigns would be maintained without change. This was also in line with the views of Japan. At any rate, the uncertainty about financial regulation has been eliminated and this is a very good thing. I believe Japanese banks and financial institutions will be amply able to deal with this new, final Basel III. That is another reason why we think this was a good result. In relation to the latter part of your question, I don't think it is appropriate for me to talk about the qualities of the person in this position. As you know, the appointment of the new Governor will be finalised by the Cabinet after approval in the Diet. So, I do not think it is appropriate for me to comment. I have already said a lot already, and I have nothing else of particular note to add.

Q: (Takahashi from Jiji Tsushin) In your previous answer on reversal rate, you said there are no problems in intermediation at this juncture. I'm wondering if problems may arise if the situation lasts long. In relation to that, there are discussions that account management fees can be introduced. I

would like to hear your view. Second on another issue. The Abe administration will celebrate its fifth anniversary next week, on December 26. I would like you to review the last five years on this occasion and request that you tell us what you expect from Abe administration in the coming year. I believe the Abe administration will continue.

G: As for the first part, I do not believe there are any problems in financial intermediation at all. As I have said before, since financial institutions have satisfactory capital and capital costs are declining, I do not believe any problems will arise in the near future. Note that I believe we will always need to closely and adequately monitor the financial system and the financial intermediation function and it is analyzed in detail and shown in biannual reports.

As for the second question, it is inappropriate for the Governor of the Central Bank to assess the government, so I will not comment at all. But if I may say something in relation to our monetary policy, since we introduced Quantitative and Qualitative Monetary Easing (QQE) in 2013, we have adjusted it as necessary. Then, I could say that consistent monetary easing has had certain results and been successful, creating the current economic situation. Note that I would not say monetary policy alone is a driver, but I believe certain positive effects of monetary policy have been apparent. In particular, there has been significant improvement in the labor market and corporate earnings are hovering at record highs. The economy has been expanding for seven consecutive quarters, growing at an average of 2%, at a significantly higher pace than the potential growth rate. The virtuous cycle of income to spending is continuing under such circumstances i.e. from the corporate sector to the household sector. I believe the conditions are favorable. I believe we have exited from deflation but in terms of the 2% price stability target, we are still far from there, so I believe we will continue monetary easing.

Q: (Atsumi of Tokyo Shinbun) I have two questions regarding ETF. Given current stock prices and comparing those with the Financial Activity Index of July-September period, I believe the overheating alarm might be set off. I would like to hear your thoughts on the recent stock market level and how the ETF purchase might be affected if the overheating signal is set off in the heat map. Secondly, there is an opinion that continuous ETF purchase under current situation may, to some extent, mean that you tolerate a certain bubble or market overheating in order to achieve the 2% price stability target. I would like to hear your view on that.

G: As you would know ETF purchases is one of the elements of the Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control framework and we conduct this with the aim of having a positive impact on the economy and prices by influencing the equity market risk premium. I believe influencing the equity market risk premium has played a major role. ETF purchases are designed in such way and it is not a policy aiming for a certain level of stock price or the equity raising

market. As I have just said, we are purchasing ETFs as one element of Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control to achieve the 2% price stability target as soon as possible. We will of course discuss policy while monitoring economic activity and prices and financial conditions.

The heat map shows deviation from the past by taking the average of more than a dozen indicators. Red does not necessary mean an overheating. However, I believe we will monitor the real economy by looking at various indicators. Anyway, I do not believe the current conditions reflect a financial overheating or bubble.

Q: (Fujioka from Bloomberg) As you have said earlier, the BOJ will set the optimum yield curve by looking at the economic activity and prices and financial conditions. As you are saying, if the economic recovery continues at the current pace, by maintaining the current level of the yield curve, I believe real interest rate would decline and the extent of coverage would strengthen. In such case, the monetary base would of course expand until the 2% price stability target is achieved. But do you have the option to raise long term interest rate target to adjust extent of easing, or do you believe strong monetary easing must be sustained if inflation is far from the 2% price stability target. Alternatively, do you lack confidence in achieving the 2% price stability target even though there is favorable economic growth?

G: Fundamentally, the BOJ's utmost target is to achieve the 2% price stability target as soon as possible and Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control is conducted in conjunction with that. Therefore, we basically will monitor interest rates at the cross point of two issues in relation to the price stability target. We will not consider interest rate hikes simply because of a favorable economy. Basically, we will consider interest rates in conjunction with the BOJ's goal of monetary policy, in other words achieving the 2% price stability target. Through such process, as I have been saying, we will maintain the current situation as long as momentum is sustained. If we fear that momentum is not sustainable, we will of course consider additional easing. On the other hand, if the 2% price stability target is viewed as achievable or almost achieved, I do not see any reason to maintain the target of yield curve control. However, since we only consider if the 2% price stability target is achievable, a favorable economy will not be a reason. I believe we need to create a situation where the 2% price stability target is steadily maintained by patiently sustaining monetary easing.

Q: (Ito from Reuters) I have a question in relation to a previous question. In operating the yield curve control policy, I believe the BOJ is assessing the extent of monetary easing by measuring the Natural Yield Curve. Although economic activity and prices have been improving, do you think the Natural Yield Curve is in uptrend since the introduction in September 2016? If so, to what extent? One more additional question. The BOJ decides on an appropriate yield curve based on three measures, such

as economic activity, prices and financial condition. If financial condition change and your views do not change in relation to economic activity and prices, will you hike interest rates based on consideration of the financial intermediation function alone? Would you explain the relationship between prices and financial condition?

G: As for the first point, we were perhaps the first to conduct yield curve control as a policy of a world central bank. It was of course initiated based on the highly probable notion that the entire yield curve can be controlled through experience of QE and negative interest rate. Then, under our Comprehensive Assessment, we discussed the type of yield curve that should be most effective for the economy. Under such circumstance, the yield curve was considerably flat when we discussed in Comprehensive Assessment. In addition, the very long end was significantly low. It was pointed out that such a situation is not positive for the economy and the fund management of pensions and life insurance companies or rather consumer sentiment was impaired. On the other hand, we found that interest rates of short to medium-term and long-term maturities shorter than 10 years have a large impact on economic expansion investments such as capital expenditure and housing investment. Therefore, we introduced the current yield curve control and I believe it has had the appropriate results. Although discussion on raising or lowering the yield curve is apparent in theory, I believe the current yield curve plays the most effective role based on our 1 year and 3-month experience.

As for the three criteria, as I said now, we noted in the Comprehensive Assessment that we set the optimum yield curve considering economic activity, prices and financial condition. Of course, I believe we will shift the yield curve if the optimum yield curve can be different from the current one based on the economic activity, prices and financial condition. But, as I have been saying, at this juncture, I do not believe we need to shift to a yield curve based on three factors. Note that as each factor has its own significance they simultaneously interact. I believe we will set the yield curve by comprehensively considering three factors. Through 1 year and 3 month experience, we gradually found that yield curve control is effective, or we found it adequately functional. However, as I believe the optimum level of the yield curve will become clearer through actual experience, I believe the yield curve of so far 1 year and 3 months has been just optimal and had positive impacts on economic activity, prices and financial condition.

Q: (Matsumoto from TV Asahi) On a different topic from monetary policy, I would like to ask about Bitcoin (BTC). The BTC market has shot up since last month and fluctuated recently. At a previous press conference, you said you were very interested in BTC. What do you think about the current situation, including whether the market is in bubbles? When the market size expands further, do you think that it will affect the BOJ's role?

G: In terms of BTC, it is a fact as you have noted that there are market transactions, large price changes,

and the market has risen sharply. I do not think that BTC plays the same role as a currency as a form of payment or settlement. Accordingly, BTC currently changes hands, in short, as a target for investment or speculation. I do not think BTC is currently a problem or obstacle for the BOJ's monetary policy, a policy, as I have said, aimed at realizing an appropriate yield curve through QQE to give a positive impact to the economy. However, BTC is not a form of payment or settlement, but a target for investment and speculation, thus as a matter of course, the Financial Services Agency must be monitoring whether BTC has an unexpected effect on consumers or the financial assets of investors. I do not think there is any effect on our monetary policy.

(What about being a bubble?)

That is not something for me to decide. Drawing a graph, I think there are extraordinary activities.

Q: (Yoshida from Nishinippon Shimbun)

2017 was the first year without any new easing or tightening measures introduced by the BOJ since you took office. What do you think about this?

My second question is about the 2018 spring labor-employment wage talks. The Rengo labor union association asks for a 4% wage hike and the Japan Business Federation (Keidanren) is about to require member companies to raise wages by 3%. What hope do you have about wage hikes, which are deemed to be indispensable for realizing a favorable cycle of price increases?

G: In deciding appropriate monetary adjustment steps, we fully analyze previous data and forecast developments in economic activity and prices, as well as financial conditions at each policy meeting. As it happened, the year 2017 had no change in our policy measures.

On the issue of wages, our monetary easing policy aims for a virtuous cycle of moderate rise in the price of goods and services while corporate revenues and wages increase. As you know, corporate revenues are now at record-high levels, the labor situation has tightened further, and the CPI has gradually risen in positive territory. So, I believe that upward pressure on wages has steadily increased. In its new economic package, determined at a cabinet meeting several days ago, the Government came up with various measures including tax breaks to support strong wage increases by companies. I do not refer to concrete figures on how far wages should rise. But the BOJ expects that both workers and employers will take positive action, utilizing the current economic environment.

Q: (Mikoda from NHK)

I have two questions. One is about competition policy for regional banks. I know that you do not comment on the Fair Trade Commission's (FTC) stance. In considering a state of monopoly by integration between regional banks, they are part of regional infrastructures, unlike other ordinary companies. If management conditions of any regional banks turn worse as a result of prohibition of business integration, the whole regional economies covered by the regional banks may be affected. Some say that the regulatory authorities should consider such circumstances. What do you think

about this?

The other question. As you have said, the inflation rate has gradually increased, and you have said that deflation is over. In the latest monthly economic report, the Japanese government said that there are changes toward overcoming deflation. The government is yet to declare that Japan has overcome deflation. Again it is not your matter whether the government will make this declaration, but you repeatedly mentioned the negative mindset affected by deflation so that people fail to believe prices will rise. Do you think that such a declaration will have a positive effect to wipe out that mindset or do you have no special expectation?

G: We are not in a position to comment on the FTC's decision. On one hand, regional financial institutions provide financial services to depositors and companies in their relevant communities. In this sense, they are community-oriented. On the other hand, finance is a business that handles money, which moves everywhere as it will. So, regional banks are surely community-oriented but they also operate beyond their communities. Considering that, I do not believe that each regional bank should be regulated by prefecture where it mainly operates. I think there would be a good idea if each regional financial institution proceeds with business integration with another one or other ones for better efficiency and improvement of regional financial services by observing characteristics of each financial institution and region.

On the second question, it is in the government's discretion whether it declares overcoming deflation. But in the current situation, in fact, there is no deflation, i.e. a state of continuous price falls. Like other central banks, the BOJ aims to realize and stably maintain the 2% inflation target. I think that the government may declare that it has overcome deflation and give an effect to wipe out the so-called deflation mindset. Anyway, as we have said in the past and committed to the Joint Declaration, we will continue our monetary easing policy tenaciously to realize the 2% target as soon as possible.

[The Managing Company: The Governor has another appointment to get to, so please ask one last question.]

Q: (Takemoto from Reuters)

U.S long-term interest rates have not risen so much despite the Fed's strict tightening policy. Conversely, there has been a fairly clear downtrend. What do you think about this?

The second question is on geopolitical risks. In the situation surrounding North Korea, are the tensions going to increase or ease next year? Which do you think we should expect?

G: On the first question, I am not in a position to comment on U.S. economic and financial conditions. But in terms of short-term interest rate moves in the near future, U.S market players see far lower levels than the FOMC's dot chart. Extending this tendency, it would be the market view in the U.S.

that long-term interest rates will not rise so much. On the other hand, the FOMC expects, at least as seen from the dot chart, that short-term interest rates will rise at a certain pace. So I see a difference between the views on interest rates of the market and the FOMC, but I do not think that the difference has led to a serious situation. As a matter of fact, the market's view is slightly different from the FOMC's.

I have no specific insight into the geopolitical risks surrounding North Korea, so I have nothing to say about the issue. Geopolitical risk is an external risk that occurs outside the economy and may have an impact on the economy, so we should pay ample attention to the risks, but I have no specific opinion on whether those risks will rise or fall.