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# A CONVERSATION WITH GOVERNOR HARUHIKO KURODA, BANK OF JAPAN

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**Introduction:**

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**Remarks:**

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**Discussion:**

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P R O C E E D I N G S

MR. WESSEL: Good afternoon. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. I'm very pleased to see so many people here on such a rainy day. I guess it was the only thing you could think of to do was come to Brookings.

But I really know that the reason you're here is that there are few more fascinating experiments in economic policy underway than the one that Governor Kuroda and Prime Minister Abe are pursuing in Japan. And while once upon a time, we in Washington looked at Japan as some kind of special, unique case, it must be something about the rice that leads them into this bad economic situation. One of the things we've learned, and both Ben Bernanke and Don Kohn, my colleagues here, have observed that it's a lot harder than we said it was when we were giving Mr. Kuroda's predecessors advice about what to do.

Governor Kuroda spent 30 years at the Ministry of Finance, 8 years at the Asian Development Bank as the president, and was appointed by Prime Minister Abe to be the central banker in Japan in March 2013, which marked a radical regime shift, a wonderful episode in seeing whether you can change the course of an economy and the course of consumer and market expectations by having a deliberate regime change. Governor Kuroda's term extends to 2018, so everything he's promised is going to be done by then, right? (Laughter)

As you may know, as I'm sure you do, recently the Bank of Japan announced that they looked over what they had done and they found that economic activity has improved, that Japan is no longer in deflation. They found that their 2 percent inflation target had not yet been achieved. They found that their previous regime change of QQE and negative interest rates had successfully pushed down the entire yield curve. And they found that this fall in lending rates had been achieved at the expense, in some cases, of the profits of financial institutions. But they said with, I think, admirable candor

that it isn't working as well as they had wanted, so we're going to have another regime change.

And what we're going to do today is have the benefit of Governor Kuroda explaining what it is the Bank of Japan's done and how they think they've done so far. Then I'll be joined up here by my friend Alan Blinder, professor of economics at Princeton, former vice chairman of the Federal Reserve Board, who's visiting at Brookings, and the three of us will have a conversation. Then I'll turn to you for questions.

I've been asked to tell people who are in the press that there are copies of the governor's remarks in the back of the room. They are, as you know, embargoed until he delivers them.

So with no further ado, Governor Kuroda. (Applause)

MR. KURODA: Thank you very much for your kind introduction. It is, of course, a great honor to have the opportunity to speak at Brookings Institution, a think tank with a long history and notable achievements.

Since the global financial crisis in 2008, declines in the natural rate of interest and inflation expectations have led to a growing debate about whether monetary policy is becoming less effective. While it is now widely recognized that this is a common challenge for major economies, Japan has faced and addressed such a challenge ahead of other economies. Against this background, it is extremely valuable to share experiences of different countries and to exchange views among academics, market participants, and central bankers during opportunities like this.

In order to overcome deflation that has lasted for 15 years and achieve the 2 percent price stability target, the Bank of Japan has conducted large-scale monetary easing by first introducing quantitative and qualitative monetary easing, or QQE, in April 2013, and QQE with a negative interest rate in January 2016. As a result, corporate profits, measured by the ratio of current profits to sales, have been at a record

high level.

The unemployment rate has declined to as low as 3 percent. The practice of base pay rise in annual wage negotiations, which was lost during the period of deflation, returned for the first time in two decades and has continued for three consecutive years.

On the price font, a measure of underlying inflation -- the year-on-year rate of change in the consumer price index, or CPI, for all items less fresh food and energy -- has remained positive for almost three years. Japan's economy is no longer in deflation, which is commonly defined as a sustained decline of prices. However, the price stability target of 2 percent has not been achieved.

At the Monetary Policy Meeting held in September, the Bank conducted a Comprehensive Assessment of the effects of these policy measures and, based on this assessment, introduced a new monetary policy framework. This new policy framework reflects the Bank's thinking with regard to the challenges that advanced economies have in common. In advance of our discussion later, I would like to talk about the essence of the new framework.

There are two major challenges to monetary policy in Japan. To start with, despite unprecedentedly large-scale monetary easing, inflation expectation formation in Japan is still adaptive to a large extent. That is, the expectations are formed in a backward-looking manner. In the wake of the substantial decline in crude oil prices since summer 2014, a reduction in the observed inflation has pushed down inflation expectations. The first challenge, therefore, is in terms of how to lift inflation expectations that had fallen once to an undesirably low level and re-anchor them at the target of 2 percent.

The next issue concerns the link between the interest rate level and the effect of monetary easing. When short- and long-term interest rates were well in positive territory, a common understanding was that so far as the impact on the economy was

concerned, the lower the interest rate, the greater the monetary easing effects. However, it is now recognized that when short-term interest rates are negative and long-term interest rates have fallen to extremely low levels, there could be side effects or costs that weaken the functioning of financial intermediation, which may reduce monetary easing effects. Such observations lead us to the other challenge, which is to explore optimal levels and shapes of the yield curve that can maximize monetary easing effects on the economy and prices.

As solutions to these challenges, the Bank recently introduced a new monetary policy framework, QQE with yield curve control. This consists of two major components: one, an inflation-overshooting commitment; and two, yield curve control. Let me talk about each of them in turn.

I will start by talking about the inflation-overshooting commitment. There is a widespread consensus that anchoring the inflation expectations is very important I achieving the price stability target set by the central government. However, it has not been fully analyzed, either theoretically or empirically, how inflation expectations are formed by the public and how they can be raised once they have been de-anchored and fallen to an undesirably low level.

QQE, introduced by the Bank of Japan in 2013, aimed at changing people's perceptions of inflation through a regime shift in monetary policy by combining a strong commitment to achieving the price stability target and the significant expansion of the monetary base. As shown in the Comprehensive Assessment, this approach has produced positive results.

In light of these achievements, the Bank of Japan further strengthened this approach recently with the introduction of an inflation-overshooting commitment in which the expansion of the monetary base is linked to the year-on-year rate of the change in the observed CPI. By committing to continuing to expand the monetary base until the observed CPI inflation exceeds the price stability target of 2 percent and stays

above the target in a stable manner, the Bank aims to work on people's perception of inflation in a more forceful manner.

As a possible policy option to address declines in inflation expectations, prominent economists such as Olivier Blanchard, former IMF chief economist and professor emeritus at MIT, and John Williams, president of the Federal Reserve Bank of San Francisco, have proposed that a central bank raise its inflation target from the current 2 percent to, say, 4 percent. However, based on Japan's experience, the argument that a central bank can lift inflation expectations of various economic entities simply by raising its inflation target seems a little naïve to me. (Laughter)

In order to re-anchor inflation expectations, I believe it necessary to strength a central bank's credibility that it can achieve its price stability target or inflation target. For this purpose, making use of forward guidance or a commitment with regard to the future course of monetary policy is considered effective. However, designing an effective forward guidance is not an easy task. There is nothing to be gained from promising the obvious.

On the other hand, promises that impose excessive constraints on future conduct of monetary policy would not be effective either because people think that a central bank would end up reneging on the commitment. This is a problem of the so-called time inconsistency.

The Bank of Japan's solution to this problem is to make a commitment that is bold, but not excessively binding by making a commitment to expansion of the monetary base, based on the observed CPI inflation rate instead of the forecast of them. Given that there is a time lag for monetary policy to have effects on economic activities, it is exceptional for a central bank to make a commitment based on the observed indicators.

In the new commitment, the monetary base continues to expand until the condition is fulfilled. That means that the Bank of Japan's holdings of Japanese

government bonds, or JGBs, keep increasing, as well, because they provide a significant portion of the monetary base. By committing to an increase in the core element of monetary easing, namely the monetary base, the Bank demonstrates that unprecedented monetary easing will be firmly in place until the observed CPI inflation rate exceeds the price stability target of 2 percent and stays above the target in a stable manner.

Under our baseline scenario in which the inflation rate increases at a fairly moderate pace, a low-level yield curve will also continue until the condition is met along with an expansion of the monetary base. That said, if inflation were to accelerate suddenly, the Bank would be able to address this by raising the short- and long-term interest rate. However, I must say that this commitment can be kept all the time while giving powerful monetary stimulus.

Some economists raise concern that the higher inflation target, even though originally designed to lift inflation expectations, would end up being long-lasting, creating a new challenge of how high of an inflation rate level would be consistent with the legal mandate to achieve price stability. The Bank of Japan's new policy framework is constructed in such a way that it can avoid this problem while maximizing the monetary easing effects.

The formation of inflation expectations and policy responses to lift inflation expectations are the subject of an ongoing debate. I strong expect these issues to be further explored.

Now I would like to talk about yield curve control. With regard to central banks' ability to control interest rates, the convention view is that they can control short-term interest rates, but not long-term interest rates. However, since the global financial crisis, major central banks, having faced the zero lower bound on short-term interest rates, have directly exerted influence on long-term interest rates through large-scale asset purchases. This policy is widely referred to as quantitative easing, or QE. In practice, all of the major central banks set the amount of asset purchases as an operating

target, and long-term interest rates consequently are endogenously determined.

However, the Bank's analyses in the Comprehensive Assessment showed that the impact of government bond purchases by the Bank on long-term interest rates have varied considerably, depending on economic circumstances and the financial market conditions from time to time. This means that when the amount of government bond purchases is set as an operating target in advance, actual long-term interest rates could be too high or too low relative to the level considered appropriate for the central bank.

Against this background, the Bank of Japan introduced yield curve control in which long-term interest rates are explicitly set as an operating target. This is perhaps the first attempt to do so among major central banks.

You may think that yield curve control is an ambitious project for a central bank. Let me remind you, however, that major central banks that have been conducting asset purchases must have already faced the question of what shape and location of the yield curve would be appropriate for their policy goals. Without answering this question, the central bank cannot reasonably specify the amount of asset purchases.

In a recent post in his blog, Ben Bernanke, former chairman of the Federal Reserve, referring to discussions at the Federal Open Market Committee's meeting in October 2010, compared QE, in which the amount of government bonds to be purchased is decided in advance, with a peg for long-term interest rates. In this comparison, Dr. Bernanke pointed out that if the Federal Reserve pegged long-term interest rates, it might end up having to buy very large amounts of securities, giving rise to the risk of losing control of the balance sheet. For this reason, the Federal Reserve decided to opt for QE rather than rate-pegging.

While I share such concerns, I have two responses to them. The first is that in the new framework, the Bank of Japan will set the operating target for long-term interest rates at each Monetary Policy Meeting. That means that it will facilitate the

formation of the yield curve that is deemed appropriate by taking account of the economic, price, and financial conditions from time to time so as to provide a sufficient level of monetary accommodation in order to achieve the price stability target.

The second is that the Bank has already been conducting very large-scale government bond purchases and, in combination with a negative interest rate policy, has been fairly successful in controlling long-term interest rates. As shown in the Comprehensive Assessment, this combination has been exerting powerful downward pressure on long-term interest rates. With this in mind, I believe that there will be no significant changes in the management of the Bank's balance sheet going forward under the new framework.

Meanwhile, in a recent book, Professor Ken Rogoff of Harvard University argues that a negative interest rate policy is more effective than QE, not least because QE has had uncertain impacts so far compared to the conventional interest rate policy, and there is difficulty in its calibration and communication. In this context, he calls for abolishment of cash or bank notes, or at least abolishment of high-denomination bank notes, as it would make further policy room for a negative interest rate. While I'm interested in his argument, the reality is that cash cannot be abolished in the near future.

From the viewpoint of policymakers, a negative interest rate policy and asset purchases are not mutually exclusive. Taking account of the existing financial system and the financial market structures in Japan, we have come to a conclusion that the Bank of Japan can proceed with more powerful monetary easing by controlling the yield curve through the appropriate combination of a negative interest rate policy and asset purchases.

In conducting yield curve control, more detailed analyses, both theoretical and empirical, on the appropriate level of short- and long-term interest rates are required. In particular, the conventional concept of a natural rate of interest and monetary policy rules are not sufficient, as they focus exclusively on short-term interest

rates. Research and discussion should be extended across the entire yield curve.

These issues are relevant for the Federal Reserve, as well, although it already has discontinued asset purchases except for reinvestment. If one stands on the stock view of QE, suggesting that what matters for monetary easing effects is the central bank's holdings of assets rather than the amount of asset purchases during a period of time, the Federal Reserve's massive bond holdings is still providing monetary stimulus. If this is the case, the level of the short-term interest rates that is desirable for the Federal Reserve at present must be different from what would have been the case if the Federal Reserve had not held such massive amounts of bonds on its balance sheet.

Moreover, based on the experience in Europe and Japan, it is becoming increasingly evident that an excessively lowered and flattened yield curve could weaken the transmission mechanism of monetary easing by squeezing banks' profit. In addition, a decline in expected rates of returns of insurance and pension products may have an adverse impact on consumers' confidence. These aspects are not only of interest from a macroprudential perspective, but also need to be examined in terms of the macroeconomic transmission and influence of monetary easing.

In sum, with interest rates at historically low levels, monetary policy design going forward necessitates a new paradigm of monetary economics by broadening the focus of analysis from short-term interest rates to the entire yield curve.

Today I was able to discuss only a couple of topics that are covered in the Bank of Japan's Comprehensive Assessment. In fact, we have conducted in-depth analyses of hotly debated issues in monetary policy, including the impact of large-scale government bond purchases on long-term interest rates, the mechanisms of inflation expectation formation, and the effects and impact of the negative interest rate policy.

As I mentioned at the outset, monetary policy under a low-growth, low-inflation environment is becoming a challenge that major economies around the world have in common. To conclude my remarks, I sincerely hope that the Bank's

Comprehensive Assessment and the introduction of the new policy framework based on this assessment will contribute to constructive debate in this field.

Thank you very much. (Applause)

MR. WESSEL: Thank you very much for those very clear remarks. At one point, when you referred to raising the inflation target as being naïve and people laughed, I told my colleague that it's one of the first times I ever remember anybody laughing at a discussion of monetary policy. (Laughter) So, once again, Japan has proved to be a leader in pushing the frontier forward.

Alan, let me first turn to you and ask you basically are they doing the right thing? What are the risks they're running and what can we learn from it?

MR. BLINDER: So we'll know if they're doing the right thing about two or three years from now. (Laughter) I like the change in policy quite a bit and I want to start by explaining why, first going back to basics and then coming to the praise, and I'm going to have a little suggestion. Don't worry, this will all be fast. It sounds like I'm about to give a speech. I'm not.

If you think back to when monetary policy was normal and nobody laughed about it, the way central banks in most countries, including Japan, including the United States, thought about it is they had control over this inherently unimportant interest rate, the overnight rate, but by moving that into kind of something between a con game and a magical trick, but mediated by markets, the whole yield curve would move. And what happened at 2-year maturities and 5-year maturities and 10-year maturities is what really mattered in addition to the exchange rate and the stock market and a variety of other things. There was a pretty big consensus that that was the way it worked. No inherent important really of the overnight interbank interest rate.

So I always wondered back then how come central banks don't focus on the 2-year rate, the 5-year rate, the 10-year? There's nothing particularly sacred about the 10-year, but it's a reasonable choice. And I want to give you an analogy to a very big

regime change in American monetary policy that you're very familiar with that then flipped back, which is Paul Volcker in October 1979 basically, at a press conference, which is not something the Federal Reserve does very -- or did in those days very often, basically told the markets we're not pegging interest rates anymore, and that was the short-term interest rates. We're pegging a quantity, so that was the money supplier or bank reserves or something.

This was considered a fundamental, very big deal regime change at the time. And so one of my little suggestions for you is I think you should make more of what a big deal this is because it really is a fundamentally different way of thinking of what you're doing. Are you controlling a price and letting the quantity go where it may? You used that in speaking about the fear that central banks have had historically of losing control of the balance sheet size. I think it would be good to shed that fear as the Bank of Japan is on the verge of doing because it's the interest rate that presumably matters, not the quantity. The quantity is a route to the interest rate.

So I think those are two pretty big steps: the switch from the quantity to the price and the basic statements, which I think -- you'll correct me if I'm wrong -- you haven't quite made sufficiently strongly to tell the markets we don't care about the quantity anymore. Stop fussing about whether it's 80 trillion or 62 trillion or 49 trillion.

(Phone rings) I'm sorry, I thought I had turned this off. This happened before. I don't know how to turn these things off. (Laughter)

MR. WESSEL: Kind of like printing money. (Laughter and applause)

MR. BLINDER: And so I think you want to make the regime change a little bit more clearer.

And one little -- it sounds like facetious, but it's not actually, one thing you should do is stop calling it QE. Remember the term QE started in Japan with the interest rate's down to zero, but we're not out of ammunition. We can throw quantity out there. And then the whole world adopted that terminology. This is not QE and it would

be great, I think, if the Bank of Japan said that early and often.

MR. WESSEL: Governor Kuroda, let me pick up on that. If you're targeting the price, why did you talk about 80 trillion yen in the statement?

MR. KURODA: I think there are two reasons. One of them is that when we introduce this new policy framework last month, we explained the yield curve control in such a way that the yield curve existing at that time was probably appropriate for the economic (inaudible; audio drop) and also it would not (inaudible; audio drop) country damage --

MR. WESSEL: I think you should speak a little louder.

MR. KURODA: It would not significantly damage financial intermediary functions of the (inaudible; audio drop) sector. So that means that 80 trillion-yen asset purchase coupled with a negative rate may this yield curve. And that yield curve we predicted as appropriate for the economic conditions. So that implies that the 80 trillion-yen asset purchase program would continue for the time being.

But as Professor Blinder clearly explained, certainly this is a regime change from a monetary base control to yield curve control. So once this yield curve control is well-established and implemented, the amount of asset purchase would be dependent on the yield curve we are implementing.

MR. WESSEL: Right.

MR. KURODA: So, as I said, under the new regime the amount of asset purchase is kind of endogenous.

MR. WESSEL: But you --

MR. KURODA: But, as I said, at this moment, probably we will continue around 80 trillion per year asset purchase because the current yield curve is quite appropriate for the economic conditions now. Plus, we may wish to further reduce, further lower the yield curve. Then we might increase asset purchase (inaudible) or if we achieve 2 percent inflation target, then, of course, the long-term interest rate would

naturally rise or we should allow 10-year JGB interest rate to rise. And in that circumstance we may reduce significantly the (inaudible; audio drop).

So I said a few things. One, for the time being, in order to achieve this current yield curve, we will probably continue to purchase 80 trillion yen per year or something like that. The second is but the regime change is regime change. And the asset purchase -- the amount of assets to be purchased is endogenous, and it could go up or go down in order to achieve the yield curve.

MR. WESSEL: But as you know -- and that's okay with the Bank of Japan.

MR. KURODA: Oh, yeah, that's right.

MR. WESSEL: That's a key thing. So if it deviates from 80, it's fine. So, as you know, I think one of the tests of a regime change is whether people understand it and take the message that you sent. And there was a great deal -- there was a very wide reaction to the Bank of Japan's announcement. And one school of thought was this is basically tapering. They're coming up with an excuse to reduce the amount of purchases. After all, they've been telling us for years that quantity is what matters. So did they just misunderstand what you were saying?

MR. KURODA: I think the market or market people now well understand.

MR. WESSEL: They now understand.

MR. KURODA: Yeah. And even if the amount of asset purchase will be lower, 80 trillion yen, if we maintain the appropriate yield curve, then it's okay.

MR. WESSEL: It's okay.

MR. KURODA: Yeah, yeah. But, also, I think the tapering, as I understand it, is the way to exit from an extremely accommodative expansion in the monetary policy and to reduce the amount of asset purchase step-by-step as a way of exiting from the accommodating monetary policy. But in our case, we do not think (inaudible) exit from extremely accommodative monetary policy at this stage.

MR. WESSEL: Right.

MR. KURODA: I mean, until we achieve the 2 percent inflation target or even overshooting the target, we will continue monetary easing. So even if the amount of asset purchase declines or it may increase or whatever, that --

MR. WESSEL: Not what matters.

MR. KURODA: That doesn't matter, as I said, if we continue to control the yield curve as appropriate.

MR. WESSEL: Right. Alan, the Bank of Japan has held very short-term rates, below zero. The Europeans and Swiss are doing that. Let me start with you, Alan. What have we learned so far about negative interest rates and then I'll ask you, as well.

MR. BLINDER: I'd like to hear Kuroda-san.

MR. WESSEL: All right, Kuroda-san.

MR. BLINDER: No, no, I'll start.

MR. WESSEL: I'm sorry.

MR. BLINDER: I'm going to (inaudible).

MR. WESSEL: Then he can criticize you. (Laughter)

MR. BLINDER: Yeah, that's exactly why I want to start.

I think what we've learned so far, and I said just in the other panel we were on, I hope that we'll learn a lot more about this in the coming years, but I think what we've tended to learn so far is that negative interest rates are neither as bad as their critics said nor as good as their boosters said. I was one of the boosters, and I had, frankly -- I was smart enough never to write down a date and a number, so I'm not on record as making a bad prediction, but I'll just admit I thought they would do more than at least they have to date.

MR. WESSEL: That negative rates would have more impact.

MR. BLINDER: Yes. Yes. So far, that doesn't look to be so, but it's in very, very early stages.

On the other hand, the arguments that I heard back from a lot of people in central banks and in -- not the Bank of Japan, but in the Fed and in markets was that this would be the end of capitalism as we know it and this was just a horrible idea and you shouldn't even go near it. That's been abundantly proven false.

Now, the two things I just said we learned are both negatives, like it wasn't as great as some people said and it wasn't so horrible as some people feared. But we need to learn a lot more about, for example, why is it -- first of all, is it and then why is it? If you go -- let's talk about the federal funds rate or whatever, or the ODR in Japan. From 0 to -50 it's different from going from 50 to 0. I think we don't know that much about that.

MR. WESSEL: I think the impression is that you tried negative interest rates. You had something of an adverse reaction from the markets and the banking system, and so that was part of what led you to try this new paradigm. Is that fair or not?

MR. KURODA: Let me say a few things first.

MR. WESSEL: Please.

MR. KURODA: When we introduced a negative rate this year, we made the system (inaudible; audio drop) two-year system. That is to say most of demand deposits at the Bank of Japan by commercial banks continue to get positive interest rates, positive 0.1 percent. And only a marginal amount of deposits would be subject to negative or -0.1 percent. Between them there are moving 0 percent deposit. So the negative interest rate policy we adopted is carefully designed so as to avoid a negative impact on banking sector profit.

But, of course, after we introduced the negative interest rate, the entire yield curve, not just the short end of the yield curve, but the entire yield curve declined and became quite flat. That means that the interest spread for the banking sector was shrunk. And that would have some impact on profitability of the (inaudible; audio drop).

So at this moment, even after the introduction of the negative interest

rate, even after the interest spread declined significantly, the Bank's lending activities continue to be quite positive. So at this moment, the financial intermediary function of the banking sector is not impaired at all. But since the decline of the lending rate, significant decline of the lending rate, which is, of course, quite stimulative to the economy, already, for instance, housing investment has started to pick up significantly because of the lower mortgage rate, and so on and so forth. So that is good for the real economy, but potentially negative impact on the banking sector, which might in the future jeopardize financial intermediary functions. So we have to be, as I said in my statement, we have to be aware of this kind of side effects.

MR. WESSEL: So you think it's not now impairing lending.

MR. KURODA: Not now. Not now, but --

MR. WESSEL: But it could.

MR. KURODA: Yeah. We continue to monitor the banking sector situation and particularly how the financial intermediary function of the entire financial system is performing.

MR. WESSEL: Okay. So right now, you have negative short-term rates and you're pegging the 10-year at 0. You said that if you have trouble reaching your objective, you might try and move the yield curve down.

MR. KURODA: Yeah.

MR. WESSEL: Is that even possible? Is this for the Bank of Japan? Is there more you could do or is this it?

MR. KURODA: I think, I mean, as I said, a combination of a large-scale asset purchase program and the negative interest rate on --

MR. WESSEL: Short term.

MR. KURODA: -- the Bank's short-term (inaudible; audio drop) by commercial banks. I think we can, if necessary. And at this stage, we think that -0.1 percent and 0 percent for 10-year JGBs' yield curve is quite appropriate. But we may be

faced with some negative shortcomings from (inaudible) or anything like that. Then we may have to reduce.

MR. WESSEL: So that would mean a lower negative rate on the short end and a negative rate on the 10-year?

MR. KURODA: Not right. That's impossible.

MR. BLINDER: If I could just --

MR. KURODA: But, again, through further reducing the short end of the interest rate into a deeper --

MR. WESSEL: Negative.

MR. KURODA: -- negative range and, of course, continued or even increased asset purchase of JGBs and so on. But, again, this is subject to economic financial conditions.

And at this stage, we expect, for instance, the Japanese economy to continue to grow by about 1 percent. And probably next fiscal year, the growth rate would accelerate towards 1.5 percent, largely because of a big fiscal stimulus package the government decided to introduce. And so the economy would move up and, at this stage, we don't think it's necessary to further reduce. But if it becomes necessary, we would not hesitate to reduce interest rates or expand asset purchase program.

MR. BLINDER: I just wanted to add, and very much agreeing with you, that I don't think it should be even a question whether the BOJ, if it felt the need and was determined to do it, could do that, pull the whole (inaudible). We look at several European countries where the central bank deposit rate is down to -75 basis points. You're not anywhere close to that. We look at several European countries where the government bond yield curve is like zero, out quite a bit, and that's without the central banks of those countries really trying to push it down.

So as long as demand curves slope down and supply curves slope up -- I'm pretty sure that's still true in Japan; I hope so -- I don't think we should have any

doubt that as long -- the key thing is what I said before and what Kuroda-san said before, as long as you're willing to stop worrying about the size of your balance sheet and do a Mario Draghi sort of thing, whatever it takes, that ends the question, yes, they can.

MR. WESSEL: Kuroda-san, when you talk about synergy between fiscal and monetary policy in Japan, what exactly do you have in mind?

MR. KURODA: You see, there are some economists arguing for so-called helicopter money.

MR. WESSEL: Right.

MR. KURODA: What does it mean is not quite clear, but, from my perspective, it is the idea to combine fiscal policy and monetary into one policy decision. Then that kind of thing is impossible in Japan or in many developed countries since fiscal policy is decided by the government and the parliament, and monetary policy is decided by the central bank, independent central bank. So under the current legal setting, it's impossible to make fiscal policy and monetary policy into one unit of decision.

On the other hand, I can say that by continuing an extremely accommodative monetary policy, fiscal stimulus could be even more effective because you can avoid an interest rate hike by increased fiscal expenditure, financed by government debt, and so on and so forth. So this kind of synergy or what you call policy mix could be quite useful.

MR. WESSEL: So are you --

MR. KURODA: But I don't say that it's helicopter money. By all definitions, it's impossible.

MR. WESSEL: But you are effectively saying to the government we're going to keep 10-year JGB yields at 0 percent no matter how many JGBs you issue, so you are making possible rather aggressive fiscal expansion if they choose to do it.

MR. KURODA: That's right.

MR. WESSEL: I see. You know, one of the things we know about

Japan is the shrinking of the population, the shrinking labor force. I think we've seen Prime Minister Abe try and increase the participation rates of women with some early signs of success, but, of course, there are limits to that. Would you recommend to the Japanese that they think about increasing immigration, either temporary or permanent, to help get things moving?

MR. KURODA: First, I think you may know that in the last year, our female participation ratio has increased more than 3 percentage points and reaching the level almost comparable to the U.S. level, not comparable to the Nordic level, but significant increase of female participation ratio. That is, I think, good.

Now, second, even if there's some room for further increase of the female participation ratio, there is, of course, a limit there. And at this moment, the population is slightly declining, but more serious is because of population aging, the workforce in Japan is shrinking by about 1 million per year. So this is a real problem.

And personally, I think we should allow many more foreign workers to come to Japan and participate in economic activities. The government has made some adjustments, particularly for construction workers. They can stay much longer in Japan.

Now, recently, the government announced that it would expand the scope of more foreign workers not from the construction sector, but some other sectors. And that would be certainly quite appropriate. So probably I think, like Singapore or some other countries, the Bank can solicit more foreign workers.

MR. WESSEL: I'm going to ask you two more questions and then I'll turn to the audience. One is one of the things we've observed, both with the U.S. dollar and the Japanese yen, is that when you get a lot of turmoil in the world and you're a safe haven currency, your currency tends to rise no matter what the Central Bank is trying to do. And you certainly have some experience with that as we have here in Washington. Is that a problem for you? Does the safe haven character of the yen limit the power of Bank of Japan easing?

MR. KURODA: As you know, our monetary policy is not targeted at the exchange rate. It is targeted at inflation rate. But, of course, exchange rate movement does affect economic conditions, particularly not just economic growth, but also inflation rates. So we are naturally interested in (inaudible; audio drop) which exchange rate (inaudible; audio drop).

Now, safe haven currency. It's not so easy to understand why because, I mean, Japan has accumulated a very large amount of debt.

MR. WESSEL: I've noticed that. (Laughter)

MR. KURODA: And yet, whatever happened in the market and particularly (inaudible) developed and (inaudible; audio drop) just as tend to purchase JGBs (inaudible; audio drop) maybe partly because -- I mean, until a few years ago, almost always Japan's yen and the Swiss franc were safe haven currencies and so on. Now, somehow, the Swiss franc escaped from that, so that the yen is apparently the only safe haven currency.

MR. WESSEL: Now, is this a problem for you?

MR. KURODA: I mean, it's not a serious problem, but from time to time it could result in excessive appreciation of the currency and could disrupt financial markets. So from time to time it could be a problem, but it may not be a lasting (inaudible; audio drop).

MR. WESSEL: It may not be a lasting problem.

MR. KURODA: But I don't know, this is not just economic and financial, but also, maybe, a matter of psychology.

MR. WESSEL: Right. And finally, what do you think the experience of Japan over the last 10 or 20 years should teach the rest of the world?

MR. KURODA: A few things. One, because we had the huge financial bubble developed in (inaudible; audio drop). And then we had a lot of problems in the banking sector and it took quite a few years to solve this problem. And because of that,

the financial intermediary function of the banking sector was impaired and may have prolonged the recession, and so on and so forth. So one lesson is whenever you have a banking sector performing a loan program or financial sector program, it's better to really address the problem and solve the problem (inaudible).

Second is from 1998 till or through 2013, we had a 15-year-long deflation, mild, but continuous, persistent deflation, and also slow growth. Deflation and slow growth. And once this kind of thing is developed, it's not so easy to eradicate this deflationary mindset, and so on and so forth. So it's better to avoid, first, going into a deflationary situation. With any or all means, you should avoid the economy going into deflation. Once in a deflationary situation it's not so easy to eradicate.

MR. WESSEL: Get out of it, yeah.

MR. KURODA: So that's the second lesson I should say. And so I really recommend policymakers in other countries they should avoid prolonged financial sector or banking sector crisis. And you should avoid the economy going into deflation.

MR. WESSEL: Right. Alan, how would you answer that question and how well are we doing on Kuroda-san's two principles?

MR. BLINDER: It depends on the country. I mean, as Kuroda-san just said, before he was head of the Bank of Japan, Japan was slow on the draw in a number of things. Now, in fairness, it was a titanic bubble and it wasn't easy and it wasn't showing up in inflation. But still, once the bad stuff started happening, within broad outlines the right things to do were clear, but some of them were painful, and it just took a long time.

I mean, the irony of that is if you look now at Japan and say, like, which central banks in the world have really done a lot? Japan's right at the top, but that wasn't true in 1994 and it wasn't even true in -- well, in 2008, it was much more equivocal depending on which problem you were talking about then. But anyway, they were slow.

By international standards, the Fed was pretty fast and I think that's a

major reason why we've come -- you know, not that they did everything right, but we've come through this better. So I think those are, you know, absolutely crucial lessons.

The other thing that I wonder about a lot, and this is not just Japan, maybe you'll have something to say about this, is whether for reasons that are only partially understood central banks are better at bringing inflation down than pushing inflation up. The kinds of things we teach our students don't really lead you to that conclusion, and it's just starting to look that way as you look around the world. I mean, Japan is the most obvious case, but the United States is another case, not as extreme. The Fed's been trying to push inflation up for a long time with not very great success. The ECB's trying to push inflation up with not very great success.

So that probably -- one thing it does is redoubles one of Kuroda-san's lessons, which is don't get into deflation. But it doesn't answer the question very much, if you get in there, how do you get out? And do we need some different instruments than what central banks have typically been equipped with?

MR. WESSEL: Is there any question you'd like to ask, Governor Kuroda?

MR. BLINDER: I had one. I was wondering if you were going to give me a chance. This has to do with central bank credibility. When you became head of the BOJ and announced the 2 percent inflation target, a lot of people, probably a lot of people in this room and certainly including me, said, wow, that's ambitious. I hope he does it, but what if he doesn't?

Now, it's clear that at least up to now it hasn't happened. And the reason that a number of people were worried about that, I think, is the loss of credibility of the Central Bank when it says we're going to do X and it does one-third X or something like that. So I wonder what you think about that. Is that a problem or do you think that a lot of economists just exaggerated the importance of credibility?

MR. KURODA: I think credibility is a very important issue. A few weeks

ago, at an international meeting we discussed about inflation targeting. And some argued that if 2 percent inflation is not likely to achieved soon, why not make a sort of intermediate target of 1 percent? And it could be achieved with less difficulty than you aim at 2 percent. By so doing, you may be able to build a sort of credibility.

But many -- or I should say almost all central bankers disagreed. And although not just in Japan, but in so many (inaudible; audio drop) countries, the 2 percent inflation target has not been met. But because we're reducing the target to 1 percent, even as an intermediate target, I don't think it would improve credibility. By so doing, you may not be able to achieve even the 1 percent target.

So 2 percent is -- at this moment it's not so easy. And also, credibility is a very important issue, but credibility does not wholly depend on the achievement of the target. I mean, if the target is slow enough, it's easy to achieve. But it would not raise credibility because a 2 percent inflation target, I think it's not only a kind of global standard, but it has its own merit and rationale.

Of course, as you know, the Consumer Price Index tends to overestimate the actual inflation rate. So 1 percent inflation may be in there it is 0 inflation or a slight deflation. And also, you would like to have some room from maneuvering for (inaudible; audio drop) of monetary policy or whatever and you would like to have 2 percent as the most appropriate inflation target. And I think this has become almost a global standard for so many central banks.

So I think credibility is a very important issue, but I don't think because we have not achieved the 2 percent inflation target our credibility has been so much undermined.

MR. WESSEL: Okay. I'm going to take some questions and I think what we'll do is we'll take three questions and allow Mr. Blinder or Mr. Kuroda to answer them, and then we'll see if there's time for more. So please.

MR. BLINDER: I think they're going to be for Mr. Kuroda.

MR. WESSEL: Well, we'll see. Please identify yourself and let's try and make them questions.

SPEAKER: (inaudible). So Governor, you mentioned that your sense it isn't profitability of the banking system because that would help propagate, right, your policy decisions. You also mentioned that in the event of an adverse shock you might try to lower the whole curve, both the short and the long end. Don't you think that would hurt the banking system because the revenues would decline, but the cost of the fund is tied to deposits and it wouldn't go down? Or do you think it would be desirable to pass negative rates onto depositors?

MR. WESSEL: Let me just take another question. Julia?

JULIA: Is the target a symmetric target with a band of wiggle room around it? Is it a ceiling? What's the intention? Is that still kind of something you're working out?

MR. WESSEL: Thank you. Krishna?

Okay. The gentleman there wiggling his finger.

MR. DIZARD: Like Dr. Spock.

MR. WESSEL: Tell us who you are.

MR. DIZARD: John Dizard with the FT. Isn't there a physical limit on the amount of JGBs that can be purchased given the fraction of JGBs you already own? And wouldn't that limit be reached at this rate before the end of your term? And if that were to happen, given the forex risks you said that you were not too concerned about at the moment, given your own recently published research on FX unwind by small hedgers who did a -- the Bank of Japan published a note in August about this, about the way small FX traders can accelerate instability. Are you concerned about those limits on what you can do: A, this physical shortage of JGBs; and, B, the instability of unwinds in yen traders?

MR. WESSEL: Okay, let's take the simple one first, the 0 percent on the

10-year. Is that a symmetric target? Is it a ceiling? How do you think of it?

MR. KURODA: I think basically symmetric, although we introduced additional measures to cap the 10-year JGB interest rate, not just continue the asset purchase, but a new measure we introduced; that is a fixed-price purchase of JGBs. So that means that if the 10-year JGB interest rate goes beyond around 0 percent and if it's deemed to be necessary, then we offer a fixed-price JGB purchase. That could effectively cap interest rates to go up.

Of course, we do not intend to use this way of JGB purchase continuously or anything like that, but if it becomes necessary we can do that.

SPEAKER: So even at zero you (inaudible; audio drop)?

MR. KURODA: Yeah, yeah, slightly higher, then you can cap.

On the other hand, if the JGB interest rates go down further, then, of course, we can reduce amount to purchase. Basically, we can adjust our JGB purchase upward or downward to maintain the JGB interest rate around zero. But as I said, if really it becomes difficult to avoid an excessive increase of interest rates, then we can offer. That is, of course, basically we will buy an unlimited amount of JGBs at that price so that we can --

MR. WESSEL: Right.

SPEAKER: Because you're more concerned about (inaudible).

MR. KURODA: You may say so, but our intention is basically symmetric.

MR. WESSEL: And Roberto's question about if you have an adverse shock, you lower the yield curve. Doesn't that imply a lot of strain on the financial system?

MR. KURODA: Oh, yeah. Yeah, that is possible and that sort of side effect we have to take into account. But at the same time, in theory there's a big shock and we need to further strengthen our monetary recommendation. Then we will do -- I mean, this is a kind of tradeoff where you have to take into account possible side effects,

but if the need for further monetary easing is so substantial, you may do that.

MR. WESSEL: (inaudible; audio drop) and the question about could you run out of JGBs to purchase before the end of your term? And if you came close to that, wouldn't that create some instability?

MR. KURODA: You see, we have been implementing QQE in the last 3-1/2 years. And we have, at this moment, something like one-third of JGBs, so two-thirds of the JGBs are outstanding. By my calculation, 80 trillion purchased can be continued more than 10 years, but I don't think it's necessary. (Laughter)

MR. WESSEL: That's good to know.

MR. KURODA: Anyway, I don't think, at this moment, there's any absolute limitation for our (inaudible).

MR. WESSEL: And there's a gentleman way in the back by the door. No, back up. The guy standing up by the door.

MR. GLASSER: Hi, Alan. Kuroda-san --

MR. WESSEL: Tell us who you are, please.

MR. GLASSER: Jay Glasser, CIO, Roppongi Capital. You've done a great job the last three or four months providing very, very detailed speeches that tell us exactly what you're doing. With NIRP, on January 29th, you talked about small European countries with a negative interest rate to 75 basis points. You constantly referred to ECB, Draghi, at -40. You're always looking at real yields, and we know that was the problem. We went from real negative yields, and that's when all the (inaudible) moved from 65 up to 120, and then we had a big reversal from negative real yields, which was on the back of a reversal in --

MR. WESSEL: There's a question coming soon, right?

MR. GLASSER: -- yeah, inflation expectations. So we have inflation expectations and nominal yields. It's very difficult to get real yields negative through inflation expectations. My question is, we're at -10 basis points at a policy rate. You've

talked about -75 for small European countries, -40 for ECB countries. The quickest way to fix the interest rate differentials or to make yields more negative is not inflation expectations at this point, but nominal yields.

MR. WESSEL: Okay.

MR. GLASSER: My question is why aren't you -- or what is it going to take to move NARP from -10 to -75 to correct the currency problem?

MR. WESSEL: Thank you. The gentleman here on the aisle, then the guy next to him. No, both of you.

MR. BROOK: Mr. Kuroda, I would like to thank you for handling the ship in this most unprecedented time for monetary policy. My question is that monetary policy, when it comes to all central banks, is that we're trying to find a way to stimulate or handle the economy at a certain point, but there's no real growth in aggregate demand. Mr. Kuroda, what can we really do to stimulate aggregate demand or at what point would you say that monetary policy has hit terminal velocity and we can't really do anything more?

MR. WESSEL: Okay. And tell us who you are.

MR. BROOK: Oh, Kenneth Brook, Investment Management Group.

MR. ASMONOV: Hello. My name is Hojin Asmonov. I'm a student and blogger. And thank you for coming, Mr. Kuroda. I have a simple question. What do you think is the biggest number one threat to the global financial markets? Is it like (inaudible), is it the regulations, or is it the (inaudible) and HFDs or whatever you think? Thank you.

MR. WESSEL: Thank you. The gentleman here.

MR. SHEARD: Thank you very much. Paul Sheard from S&P Global. The framework, Mr. Kuroda, of course, is called yield curve control, but technically you're targeting one point out the yield curve, which is a 10-year nominal rate. Could you give us a little bit of insight how you're thinking about the whole of the yield curve? Are you

thinking about doing twist operations? Are you expecting the long end past the 10-year point, perhaps to -- yields to move up quite sharply? So where does the targeting of the 10-year extend to the whole yield curve?

MR. WESSEL: Okay, so the first question is you like negative rates. You got -10 basis points. What's stopping you from doing -40 or -75?

MR. KURODA: I agree that technically it's possible to go to -40 basis points or -75 basis points because, as you said, ECB does implement -40 basis points interest rate and Swedish Central Bank, I think --

MR. WESSEL: Swiss.

MR. KURODA: Swiss, -75 basis points. So technically it's possible, but, as I said, at this moment, we do think that -0.1 percent or 10 basis points is appropriate. And if we go further into the negative territory, it could have a negative impact on the profitability of the financial system, and so on and so forth on the one hand. But on the other hand, it could have a stronger positive impact on the real economy. So you have to trade off and balance. That is basically the decision is dependent on the economic and financial situation at that time.

MR. WESSEL: And what about the other end of the yield curve, the 20 and the 30? Do you have a view on it?

MR. KURODA: You see, why we decided to pinpoint, so to speak, to (inaudible; audio drop). I mean, pinpointing just one point is not very useful to make your appropriate income. But fixing two points you can have reasonable income growth. Even if you fix two points, there may be some different kind of thing. But we continue to make large-scale JGB purchase in a balanced way, not just 10-year, but 2, 3, 5, 7, 10, 15, 20, and so on and so forth, in a balanced way so as to realize the appropriate yield curve.

But we don't think it's necessary and don't think it's useful to pinpoint every --

MR. WESSEL: But are you saying that if the 20 and the 30 are a little higher and that makes life a little easier for the life insurance companies and the pensions, that's okay with you?

MR. KURODA: I think I have to say I think the yield curve is okay. So I'll just say we don't think it's necessary to further (inaudible). But at the same time, I can say that 20-year or 30-year interest rates, even if they are low, will not have much positive impact on the real economy.

On the other hand, certainly it will have a significant negative impact on insurance companies and pension funds, so that, again, you have to balance.

MR. WESSEL: And I think the other question framed a little differently, you've made the point that if there's an adverse shock, you can always lower the yield curve. But looking across the world, do you think we're at the point where monetary policy has basically done what it can?

MR. KURODA: You mean --

MR. WESSEL: Has monetary policy across the world basically at the limits of its potency?

MR. KURODA: Yeah, I think this is sometimes discussed. I mean, actually, during the meeting here in Washington, we discussed about monetary policy. And certainly, we agree that developed economies have been relying heavily on monetary easing to recover their economies. That is true. But I don't mean that monetary policy is now faced with (inaudible) in the sense that you cannot further relax or further strengthen the easing. I don't think we have concluded in such a way, although, of course, if we continue extremely expansionary, accommodative monetary policies so long, you may have some financial stability implications.

As the gentleman here said, that it may have some negative impact on profitability of the banking sector. Eventually, an exaggeration of financial intermediary functions, and so on and so forth. So this kind of thing must be certainly borne in mind.

But that does not mean that already we have reached the limit so that you cannot -- I don't think so.

MR. WESSEL: Alan, how would you answer that question? Is monetary policy about at the limit of what it can do?

MR. BLINDER: I think it's not at the limit, but it's not that far from the limit compared to where we started. And if a central bank is rationale, and they aren't all, but they're more rational than irrational, they trot out the most powerful weaponry first and then they move into weaker weaponry. That's certainly what the Federal Reserve did, very obviously. And I'm not criticizing it; that seems sensible to me for many of the reasons Kuroda-san said. You don't want to get into these horrible situations.

So if that's true, and given how long and how hard they've been working on monetary ease, it stands to reason that they're now looking at -- you know, it's not the machine guns and the bombs, it's the peashooters and things like that that are left. And I think that's sort of true in a lot of countries.

MR. WESSEL: Okay. I'm sorry we don't have time for more questions. I apologize for that, but I want to thank everybody for coming. And I particularly want to thank Alan Blinder and Governor Kuroda. (Applause)

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