Remarks

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Thank you Professor Singleton. Three years ago, on the very same day, I participated in the panel discussion at the First Joint Central Bank Research Conference in Washington D.C. I am very glad to be able to join the panel discussion at the Second Conference again. When the Federal Reserve colleagues, Allen and other colleagues, originally proposed this plot, as an old central banker, I promptly realized that the discussions in this Conference would not always be easy, for me at least, to understand. However, the old may very often dare to insist on something without exactly understanding it. I just decided to follow this old man's custom and asked my colleagues at the Bank of Japan to cooperate with colleagues at the Federal Reserve. Through two days of discussion, I recognized that my original instinct was quite right.

I'm afraid Allen may have already noticed. This is not the first time that I speak these words. I simply read the record of my words at the First Conference. Now, through two days of extremely stimulating and provocative discussions, as an even older central banker, I reconfirm even more stubbornly that my original instinct was quite right.

Risk management and systemic risk have much more often been discussed in the context of sound banking practice, bank supervision, payment systems and the lender of last resort function of the central bank. Actually, I myself participated in these discussions on many occasions, especially when I attended the Basle Committee on Banking Supervision and the BIS Payment System Committees. But now, as I am now in charge of monetary control, I would avoid going back to those previous areas but rather go straight to my own area.

Since I became responsible for the management of monetary policy, I found, or was urged or compelled to recognize, the importance of systemic risk issues, also in the context of monetary policy. Mr. Hartmann defined systemic risk as "the risk of experiencing a systemic event in the strong sense." I suppose many people in the market felt this systemic risk in Mr. Hartmann's definition during the course of the recent global financial market turmoil, even if systemic risk, fortunately, was not always realized. I believe those people were pleased and became more confident that a systemic event wouldn't be realized, when the Federal Reserve cut the federal funds rate twice.

Systemic malfunctioning might be more serious in Japan. We have been experiencing the highly nervous attitude of market participants to almost every kind of risk and banks have been quite reluctant to extend credit.

Let me show you some examples. We experienced almost everywhere in the market an ample amount of risk. This risk premium has not always been very large, but it has almost always been fairly volatile. Thus, it was extremely difficult for us to know in advance the exact future course of the risk premium. Under such conditions, I think it is very difficult to know the level of interest rates in a textbook context. Usually, for example, the interest rate of the Treasury may be considered to be the so-called risk-free interest rate. But, in a world where such a risk premium is prevailing, even the risk-free interest rate in an ordinary situation might be strongly affected by the so-called “flight-to-quality” behavior of almost all the market participants. Therefore, in that respect, a textbook style of monetary policy agenda might not be applied directly to the recent Japanese situation.

Difficulties are not confined to the price aspects. Difficulties are observed in the accessibility to the market or to credit for almost all market participants. Most of the participants in this Conference have been talking about the issue of market liquidity. I completely agree with the importance of this issue.

In such an environment, of course, corporate financing has been in a very difficult situation. People believe such a situation interrupts or hinders the normal functioning of the transmission mechanism for monetary policy as a whole.

The basic countermeasure against such situation is, as most people believe, to inject enough capital into an individual banking institution to recover the credibility of that institution. In fact, the Japanese parliament recently set up a comprehensive legal framework for the huge scale injection of public money into the ailing banking institutions. But, at the same time, the Bank of Japan has always been watching the negative impact of the systemic malfunctioning of the financial system on the macroeconomy. This might correspond to “vertical” systemic risk in Mr. Hartmann’s terminology.

We also suppose Mr. Cheng’s remark—“policy setting to define the contagious process which in turn reshapes the risk distribution among participants, markets and systems”—is fully applicable also to monetary policy.

Actually, the Bank of Japan has long been maintaining a very easy monetary policy with a view to supplying enough liquidity, in my personal view, considering the above-mentioned two aspects of systemic risks. On top of that, last Friday, the Bank of Japan announced a package of measures to help corporate sector liquidity financing. We devised new channels of high-powered money supply which are more or less connected to corporate financing.

Of course, a lot of discussions, positive and negative, are going on concerning the Bank of Japan’s monetary policy. We very much welcome you, the participants in this Conference, to add a new perspective to our discussion.

Thank you.