

January 22, 2013

Bank of Japan

The "Price Stability Target"
under the Framework for the Conduct of Monetary Policy

1. The Bank of Japan conducts monetary policy based on the principle that the policy shall be aimed at "achieving price stability, thereby contributing to the sound development of the national economy." At the Monetary Policy Meeting held today, the Policy Board reviewed the "price stability goal in the medium to long term" adopted in February 2012, in light of the above-mentioned principle. As a result, it decided to introduce the "price stability target" and restate the framework for the conduct of monetary policy.
2. "Price stability" is defined conceptually as "a state where various economic agents including households and firms may make decisions regarding such economic activities as consumption and investments without being concerned about the fluctuations in the general price level." Therefore, "price stability" must be the one on a sustainable basis.
3. The newly-introduced "price stability target" is the inflation rate that the Bank judges to be consistent with price stability on a sustainable basis. The Bank recognizes that the inflation rate consistent with price stability on a sustainable basis will rise as efforts by a wide range of entities toward strengthening competitiveness and growth potential of Japan's economy make progress. Based on this recognition, the Bank sets the "price stability target" at 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI) -- a main price index.
4. Previously, the "price stability goal in the medium to long term" was in a positive range of 2 percent or lower in terms of the year-on-year rate of change in the CPI and the Bank set a goal at 1 percent for the time being. This time, replacing a "goal" with a "target" and setting that target at 2 percent in terms of the year-on-year rate of change

in the CPI are based on the following recognition.

The Bank recognizes that the inflation rate consistent with price stability on a sustainable basis will rise as efforts by a wide range of entities toward strengthening competitiveness and growth potential of Japan's economy make progress. Today's expected rate of inflation has been shaped over the years. As the strengthening of growth potential makes progress going forward, the actual rate of inflation would gradually rise and accordingly the expected inflation rate of households and firms is likely to rise as well. Going forward, as prices are expected to rise moderately, it is judged appropriate to clearly indicate the target of 2 percent in order to anchor the sustainable rate of inflation.

Switching from a "goal" to a "target" reflects an increasing awareness regarding the importance of flexibility in the conduct of monetary policy in Japan. The effects of monetary policy permeating economic activity and thereafter prices require a considerable and variable time lag. The conduct of monetary policy has to be flexible by examining various risk factors, including those related to financial imbalances, in addition to the assessment of current developments and outlook for economic activity and prices, from the perspective of achieving sustainable growth with price stability. Such understanding has been widely shared around the globe; particularly, in the aftermath of the global financial crisis, major economies of the world have come to emphasize flexibility in the conduct of monetary policy -- by, for example, publicly articulating the importance of paying due attention to financial system stability. Over the last year, there has been an increasing awareness of such understanding in Japan as well. In such circumstances, it is judged transparent and appropriate to use the expression, "target," in order to explain the Bank's thinking on price stability.

5. In order for Japan's economy to overcome deflation as early as possible and return to a sustainable growth path with price stability, efforts by a wide range of entities to strengthen growth potential are crucial. The Bank will continue to thoroughly examine the progress toward strengthening growth potential and the ensuing developments in the expected inflation rate of households and firms. In the meantime, the Government has shown its intention to aggressively pursue steps for strengthening competitiveness and growth potential of Japan's economy and to steadily promote

measures aimed at establishing a sustainable fiscal structure.

6. The Bank will continue to conduct monetary policy, based on its assessment of economic activity and prices from two perspectives, in the context of the "price stability target."

The first perspective is examining, as regards economic activity and prices over the next two years or so, whether the outlook deemed most likely by the Bank of Japan follows a path of sustainable growth under price stability.

The second perspective is examining, in a longer term, various risks that are most relevant to the conduct of monetary policy aimed at achieving sustainable growth under price stability. In particular, financial imbalances will be examined as a risk that will significantly impact economic activity and prices when they materialize, although the probability of their emergence is low.

The Bank of Japan will, in light of deliberations from the two perspectives described above, outline the current view on monetary policy, and disclose it periodically mainly in the *Outlook for Economic Activity and Prices* (Outlook Report).