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IMF Team Completes the 2009 Article IV Consultation Discussions with Japan

An International Monetary Fund (IMF) team, led by Mr. James Gordon, Senior Advisor in the Asia and Pacific Department, visited Tokyo during May 12-20 to conduct the annual Article IV discussions with Japan. The team held discussions with senior officials from the government, the Bank of Japan (BoJ), and private sector representatives on recent economic developments and the policy challenges ahead.

At the conclusion of the visit, the mission issued the following statement:

“The global crisis has highlighted Japan’s close integration with the global economy. While Japan was not at the center of the initial crisis, the collapse in external demand and financial spillovers from global markets have plunged the economy into a severe recession. Japanese policymakers have responded forcefully by providing much needed fiscal stimulus and monetary policy support, which should contribute significantly to growth this year and next.¹ Despite such actions, the outlook remains uncertain. A sustained recovery is expected to take hold in 2010, but much depends on the timing and strength of the global recovery. With considerable slack in the economy, inflation is projected to remain mildly negative until 2011.”

“In this difficult environment, the authorities face a number of important challenges in supporting near-term growth, ensuring a sustainable fiscal position, and pursuing reforms to rebalance the economy. On monetary policy, the BoJ’s policy response to the crisis—including policy rate cuts, measures to ensure the stability of financial markets, and steps to facilitate corporate financing—has been timely and effective. In our view, monetary policy needs to remain accommodative in the period ahead and stand ready to provide further support in the event the outlook deteriorates further or financial stresses reappear.”

¹ At this stage, we retain our April 2009 World Economic Outlook projections that GDP will contract 6¼ percent in 2009 and expand ½ percent in 2010. The mission will update its growth projections prior to the Article IV Board meeting in July on the basis of the Q1 GDP data release and other indicators.

“Fiscal policy should also remain flexible to address further downside risks. Japan’s stimulus spending is sizable at almost 5 percent of GDP—well above the G-20 average—and additional stimulus could be provided should the recession persist longer than expected. At the same time, in light of the rapid rise in public debt and fiscal pressures from the aging society, it will be important to outline a medium-term consolidation strategy to take effect once the crisis abates. Such a strategy is likely to require expenditure measures and comprehensive tax reforms, including a commitment to raise the consumption tax after the recovery takes hold.”

“Financial policies should continue to focus on strengthening the resilience of the system to risks from a more protracted slowdown. Bank profits have declined on rising credit costs and large losses on equity holdings, while the corporate sector has been hit hard by the collapse of global demand and tighter financial conditions. Priorities going forward should be to strengthen bank capital and profitability, reduce the risks from bank equity holdings, and promote the restructuring of distressed but viable firms.”

“Structural reforms are needed to help rebalance growth over the medium-term. In this context, concerted efforts to deregulate the agricultural and services sectors—including medical, child, and elderly care—could create new drivers for growth and job creation. Further reforms to encourage inward FDI, financial market development, and product market flexibility could also support rebalancing and help Japan to adjust to changes in the global economy.”