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March 30, 2022

**Statement by Mr. Hilbers and Mr. Tsur on Japan  
(Preliminary)  
Executive Board Meeting  
April 1, 2022**

*We thank staff for the comprehensive report including the set of important Selected Issues Papers, and Mr. Tanaka, Ms. Kashima, Mr. Naka, and Ms. Ogihara for their informative Buff statement. The Japanese economy is on a growth path thanks to the authorities' comprehensive policy response to the COVID-19 pandemic. However, the growth outlook is clouded by near-term uncertainties and the government should address structural challenges to growth. Therefore, we welcome the government's comprehensive agenda on climate, digitalization, and labor market reforms, and the focus on these issues in the Buff statement.*

**We agree with staff that the fiscal stimulus and high vaccination rate could support growth in 2022, but we reiterate that certain risks are elevated.** Like in other countries, the uncertainty around the pandemic and Russia's war in Ukraine poses large downside risks to growth in 2022. Furthermore, a sharp tightening of global financial conditions will limit the government's capacity to reproduce a similar level of stimulation as conducted after the COVID-19 outbreak. Additionally, we expect inflation to pick up stronger, compared to staff's forecast, due to higher global commodity prices and continued supply disruptions.

**While debt is sustainable in the near-term, we echo staff's call to rebuild fiscal buffers to ensure debt sustainability in the medium- and long-term.** Debt rollover and issuance risks are low in the near-term. However, the impact of fiscal support might be lower than envisaged, given the declining effectiveness of recurrent stimulus. Near-term policy should increasingly shift towards more targeted measures and should be adjusted according to its potential to enhance growth on the one hand and mitigate future fiscal risk on the other hand. Such a balanced approach can increase the confidence of creditors and strengthen the ability of the government to respond to shocks. As staff argues, fiscal adjustment will require measures not only on the expenditure side but also on revenue. Therefore, we particularly welcome the comprehensive analysis by staff on options for revenue mobilization.

**We concur with staff's view that the Bank of Japan should maintain its accommodative monetary policy to support the economy and increase inflation closer to the central bank's 2% inflation target.** We commend the BoJ for the adjustments it has made to its monetary policy framework, including the newly introduced interest subsidy scheme to address the reduction of lending margins associated with negative policy rates and to incentivize loans to targeted activities. We agree that this policy contributes to a more sustainable and nimble monetary policy.

**Financial supervision should remain vigilant to contain potential vulnerabilities.** While the authorities and staff consider the financial system to be stable, it remains important to continue closely monitoring its functioning amid an environment of elevated uncertainty, prolonged low interest rates, and adverse demographic developments. This environment may generate headwinds to the financial system and risks to financial stability, particularly for regional banks. We commend the authorities for their progress in implementing the 2017 FSAP recommendations, by prompting measures to reduce systemic risks.

**We strongly agree with staff's comprehensive assessment of Japan's agenda for green, digital, and inclusive policies.** On climate, renewed momentum toward reducing carbon emissions is an important and positive action to mitigate climate change. Given the high reliance on fossil fuels and the low share of renewables, carbon pricing should be scaled up to reach zero net emissions by 2050. On digitalization, the pandemic highlighted Japan's challenges in that field. Japan lags other OECD countries in digital adoption by private and, notably, public sectors. While recent measures to accelerate digitalization are a step in the right direction, a successful digital strategy needs to incorporate well-designed incentives and educational campaigns to equip society with the necessary digital skills and enable a change in norms and behavior. These steps can also promote inclusiveness, especially if accompanied by further incentives to boost female and elderly labor, against a backdrop of demographic challenges.