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Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on April 26 and 27, 2017

I. Opinions on Economic and Financial Developments

Economic Developments

- A positive output gap has been taking hold in Japan with the virtuous cycle led by exports and production becoming firmer. The Bank should revise its economic assessment upward to one stating that Japan's economy "has been turning toward a moderate expansion."
- Given that a positive output gap has been taking hold, the Bank should make an upward revision to its economic assessment by describing the economy as "having been turning toward a moderate expansion."
- Japan's economy has been turning toward a moderate expansion. Going forward, with accommodative financial conditions, it likely will continue growing at a pace above its potential mainly on the back of a pick-up in overseas economies and the government's stimulus package.
- Japan's economy has been turning toward a moderate expansion. Although an improvement in domestic demand is not remarkable, the economy is likely to continue growing at a pace above its potential in fiscal 2017 and fiscal 2018, with its underlying trend strengthening.
- Japan's economy is likely to maintain growth at a pace above its potential, mainly through fiscal 2018.

¹ English translation prepared by the Bank's staff based on the Japanese original.

² "Summary of Opinions at the Monetary Policy Meeting" is made through the following process: (1) each Policy Board member and government representative makes a summary of opinions that she/he presented at the Monetary Policy Meeting (MPM) under a certain word limit and submits this to the Governor of the Bank of Japan, who serves as the chairman of the MPM, and (2) the chairman edits those opinions as his responsibility.

- Japan's economy is expected to maintain growth at a pace above its potential, mainly through fiscal 2018, as production has reverted to an uptrend reflecting an increase in exports. With regard to the risk balance, risks are skewed to the downside, particularly those regarding political situations in Europe, the U.S. economic policies, and geopolitical issues.
- The global economy has been improving steadily, as seen in stable commodity prices including crude oil prices and a recent increase in investment in the mining industry.
- It is expected that the virtuous cycle in the economy will be getting firmer, led by manufacturing, as was the case in the economic expansion phase in the mid-2000s. However, compared to that phase, the positive effects on private consumption would be slower to spread due to the aging population, which has progressed further.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is likely to increase toward 2 percent, as the output gap improves and inflation expectations follow an increasing trend with a rise in the observed inflation rate backed in part by developments in energy prices. The timing of the rate of change in the CPI reaching around 2 percent is likely to be around fiscal 2018. Thereafter, the rate of change is expected to remain at around 2 percent.
- The declines in prices of and charges for mobile phones -- which are pushing down the CPI in recent months -- have been brought about by a sectoral shock that is not related to factors determining the general inflation trend, such as the output gap and inflation expectations.
- Although prices are sluggish recently, they are likely to start rising clearly as the economy continues its moderate expansion and the output gap widens further within positive territory. At this point, there is no reason to significantly change the Bank's outlook for prices, and it is important to carefully monitor price developments through the second half of 2017.
- The year-on-year rate of change in the CPI (all items less fresh food) is likely to gradually increase toward 2 percent, due in part to the upward pressure stemming from developments in commodity prices. However, it would take some time for the inflation rate to accelerate, as the formation of inflation expectations is adaptive.
- Looking ahead, actual prices will rise along with wage increases that reflect labor shortages, and inflation expectations will also rise gradually. Under such circumstances, the

year-on-year rate of change in the CPI is likely to turn to an uptrend, reaching about 2 percent at around fiscal 2018.

- As scheduled cash earnings at small and medium-sized firms -- which employ the majority of workers -- have been growing steadily, an increasing number of households can now feel that their wages actually have been rising. This is important in terms of raising inflation expectations of the public.
- There is uncertainty regarding the momentum to push up inflation expectations through the "adaptive expectation formation mechanism." It is important to monitor the spread of wage increases and developments in firms' price setting after the turn of fiscal 2017.
- In general, sales of retailers vary substantially depending on business hours. Labor productivity would rise if retailers discontinue late hours instead of raising wages of employees working such hours. If this change prevails among a wide variety of retailers, the labor productivity of Japan's economy as a whole would also rise. This is favorable for Japan's economy. However, the reduction in business hours -- which lowers the demand for employment -- would constrain wage growth for the time being, slowing the pace of acceleration in the inflation rate.
- Given that there is considerable room to raise productivity, mainly in the nonmanufacturing sector, firms are unlikely to raise wages simply because of labor shortages.
- Moves to raise prices of goods and services observed at the beginning of the fiscal year are not as conspicuous as in the past few years. There also is anecdotal evidence of price declines.
- It is difficult to expect that the inflation rate would rise very sharply during the projection period of the *Outlook for Economic Activity and Prices* (Outlook Report).
- My outlook is that the year-on-year rate of change in the CPI will remain considerably below 2 percent during the projection period of the Outlook Report -- that is, through fiscal 2019.

II. Opinions on Monetary Policy

- The momentum toward achieving the price stability target of 2 percent is maintained, but is not yet sufficiently firm. While continuing to carefully examine price developments, it is important for the Bank to adhere to the current powerful monetary easing.

- Given that upward pressure on prices is moderate, the Bank should continue with the current monetary policy in order to support the virtuous cycle in the economy with the aim of achieving the price stability target of 2 percent. It is necessary that the Bank continue to work persistently toward completely overcoming deflation while deepening the public's understanding of the price stability target.
- As the formation of inflation expectations is dominantly adaptive in Japan, it takes more time than in Europe and the United States to achieve the price stability target of 2 percent. With this in mind, the Bank should persistently pursue "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control."
- For the time being, considering uncertainties regarding political and economic situations overseas, as well as increasing geopolitical risks, the Bank should maintain accommodative financial conditions by persisting with the current framework.
- Many people are concerned that labor shortage might constrain economic growth; however, the current economic conditions provide a great opportunity for firms to transform their business models, as the practical use of cutting-edge technologies such as artificial intelligence (AI) has taken hold and competition within and across the industries is intensifying. I believe that keeping on the path toward overcoming deflation will encourage such efforts of firms, and thereby raise productivity as well as the potential growth rate. In this regard, it is important that the Bank continue with powerful monetary easing, in addition to the government promoting its growth strategy.
- Some argue that monetary easing allows firms with low productivity to survive, hampering restructuring of the economy as a whole. However, if the central bank dares to raise interest rates in order to drive out firms with low productivity, the number of unemployed is likely to rise. In such situations, production in Japan's economy as a whole will decrease, even if the labor productivity of an individual firm would improve. On the other hand, the tight labor market conditions and upward pressure on wages, both of which have been caused by monetary easing, will encourage the exit of firms with low productivity, thus enhancing the productivity of the economy as a whole without causing a rise in the unemployment rate. It is therefore important to continue with strong monetary easing.
- It was assumed from the outset of the current policy framework that the amount of Japanese government bond (JGB) purchases would vary depending on situations. There has been no conflict between the current conduct of market operations and the approximate amount of

JGBs to be purchased -- that is, an annual pace of increase in the Bank's JGB holdings of about 80 trillion yen.

- I am in dissent with setting the target level of 10-year JGB yields at around 0 percent, but there is no need for the Bank to raise the target level ahead of the markets. It is desirable that it raise the level by following a rise in market interest rates, as the outlook for the underlying trend in inflation is to be shared by market participants and the Bank. In addition, the Bank should conduct the purchases of the long-term JGBs in a flexible manner; it should reduce the amount of purchases when possible in preparation for the manifestation of risks going forward. There also remains room for further reduction in the amount of purchases of JGBs with short maturities.
- The Bank's policy of achieving the price stability target of 2 percent at the earliest possible time has reduced the flexibility in the Bank's conduct of monetary policy. It is therefore better to set the goal as a medium- to long-term target.
- Unless the pace of JGB purchases is further decelerated, the sustainability and stability of the purchases will not be secured through the next year. The supply-demand conditions in the JGB market will tend to tighten further in terms of "flow," as the gross amount of JGB issuance by the government is to be reduced, as well as in terms of "stock," as the room for a further reduction in the JGB holdings by the private sector is narrowing. Therefore, the Bank should instead set the amount of increase in its assets as the operating target and reduce the amount incrementally in a gradual and orderly manner.

III. Opinions from Government Representatives

Ministry of Finance

- The budget for fiscal 2017 was approved by the Diet on March 27. The government would work to smoothly and steadily implement the budget.
- In the Japan-U.S. Economic Dialogue, it was agreed to proceed with discussions based on three pillars: a common strategy on trade and investment rule and issues; cooperation in economic and structural policy area; and sectoral cooperation.
- The government expects the Bank to continue to work toward achieving the price stability target under "QQE with Yield Curve Control" in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- With regard to working-style reforms, the government would adhere to the contents of the action plan and submit bills to the Diet at an early date. As for the Economic Measures for Realizing Investment for the Future, it would carefully monitor the progress in their implementation, including in public construction works. The government expects wage increases to be realized at a wide range of firms in the annual spring labor-management wage negotiations.
- The government expects that the Bank will steadily work toward achieving the price stability target of 2 percent in light of developments in economic activity and prices, as well as financial conditions.
- The government expects the Bank to continue to fully explain to the public the situation of its monetary policy management and the outlook for prices.