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January 31, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on January 22 and 23, 2018

I. Opinions on Economic and Financial Developments

Economic Developments

- With advanced and emerging economies growing in a well-balanced manner, a cyclical improvement in the manufacturing sector has started to take place on the back of production and trade activities becoming active. Under such circumstances, the global economy is likely to continue growing firmly for the time being.
- The global economy is likely to continue growing for some time. However, the risk that events related to the U.S. economy and geopolitics will lead to a correction in global financial markets warrants attention.
- Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Going forward, it is likely to continue expanding on the back of highly accommodative financial conditions and underpinnings through the government's past stimulus measures.
- Japan's economy has been growing in a well-balanced manner. An increase in demand has been supporting an expansion in the economy's supply capacity, such as through firms' efforts to raise productivity, business fixed investment with a view to expanding production capacity, and an increase in the labor force participation rate.

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.

- With an expansion in supply capacity, the economy's medium- to long-term growth potential has been rising. This change can be considered as an indication that hysteresis effects brought about by the prolonged shortage of demand and deflation have been waning.
- Japan's economy is expanding moderately. With households' and firms' cautious behavior gradually becoming active, it is likely to continue growing at a pace above its potential in fiscal 2017 and 2018. Thereafter, the growth pace is projected to decelerate in fiscal 2019, due in part to the effects of the scheduled consumption tax hike.
- In considering future economic growth and price developments, how the social security system, which has been a restraining factor for private consumption, will be reformed going forward is important.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations.
- In addition to price rises in goods traded in the corporate sector, reflecting the increase in crude oil prices, the likelihood of wage increases has been increasing, driven by the tightening of labor market conditions and the government's initiatives. Going forward, these developments are expected to push up the CPI.
- Firms' price-setting stance is becoming bullish gradually on the back of an improvement in the employment and income situation, as well as a pick-up in business sentiment that reflects a rise in stock prices.
- The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase moderately toward 2 percent. However, while the output gap has been improving steadily, it seems to take some time to reach 2 percent as the inflation expectation formation is adaptive.
- Considering that the male employment rate is still low and that the ratio of young generation employees -- for which the unemployment rate is usually high -- has become lower compared to the past, it is estimated that the price stability target of 2 percent cannot be achieved unless the unemployment rate -- which is 2.7 percent at present -- declines to around 2 percent. Although this is just an estimate, the current unemployment rate needs to be lowered further in order to achieve the target.

- Inflation is still sluggish when excluding the effects of crude oil prices. It is difficult to say that the output gap and inflation expectations are sufficiently working as a driving force to push up prices toward achieving the price stability target.

II. Opinions on Monetary Policy

- The year-on-year rate of increase in the CPI excluding fresh food has been accelerating. However, as it has continued to show relatively weak developments excluding the effects of a rise in energy prices, it is necessary to pursue the current powerful monetary easing with persistence.
- The Bank should continue with the current monetary policy with the aim of persistently encouraging the virtuous cycle to take hold and achieving the price stability target.
- As there is still a long way to go to achieve the price stability target of 2 percent, it is appropriate to maintain the current monetary policy.
- Although the environment surrounding prices is considered to have improved slightly, firms' actions to raise prices have remained limited. Therefore, it is judged as necessary to persistently conduct monetary policy so that highly accommodative financial conditions are maintained.
- Given the tenacious deflationary mindset, it may take considerable time to raise inflation expectations through the adaptive formation mechanism. It is necessary to continue to pursue powerful monetary easing with persistence, thereby supporting in a sustainable manner the positive price developments that have started to be observed.
- Amid the situation of the inflation rate increasing toward 2 percent and the economy's medium- to long-term growth potential rising going forward, the effects of monetary easing measures will be enhanced. While taking into account such changes in the environment as well as the side effects of the measures, it also may be necessary to consider what the desirable policy conduct would be going forward.
- When it is expected that economic activity and prices will continue to improve going forward, the situation may occur where the Bank will need to consider adjustment of the level of interest rates under the framework of "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," including from the perspective of strengthening the sustainability of the framework.

- By having yields on Japanese government bonds (JGBs) with maturities of 10 years and longer broadly lowered further, the momentum toward widening the output gap should be strengthened so that prices will be pushed up further.
- As there is still a long way to go to achieve the price stability target of 2 percent, it is not favorable to let market expectations regarding the adjustment of monetary easing heighten at an early stage. The Bank needs to show its strong stance toward achieving the target by taking additional easing measures and strengthening its commitment. If a reduction in the purchase amount of super-long-term JGBs could have an unintended signal effect on monetary policy, it should be corrected.
- The amount and timing of the JGB purchases are determined practically in accordance with the guideline for market operations decided at the MPM, and the conduct of market operations has no implications for the future monetary policy stance.
- Although there does not seem to be any problem with the financial system and the functioning of financial intermediation by financial institutions at this stage, due attention needs to be paid to the changes in the market environment at home and abroad, such as the flattening of the yield curve for U.S. Treasuries and the rise in financial institutions' funding costs for foreign currencies, and their impact on the profits of financial institutions and the financial system.
- The discussion on the reversal rate that lowering interest rates would discourage bank lending, resulting in mitigating the effects of monetary easing, is similar to the one that banks' capital constraints would reduce their lending, resulting in deterioration in economic activity. Such discussion focuses on one aspect of funds provision, not fully taking into account alternative means of raising funds by firms and the increase in their borrowing needs.
- With regard to the purchases of risky assets including exchange-traded funds (ETFs), given that stock prices and corporate profits have substantially improved and are expected to continue to develop firmly going forward, their policy effects and the possible side effects should be examined from every angle.
- In order for Japan's economy to overcome deflation and achieve sustainable growth, it is important for the government and the Bank to work together in pursuing macroeconomic policy in a powerful manner, while taking into account medium- to long-term fiscal sustainability. Given the high ratio of the amount outstanding of government debt to GDP and a future increase in fiscal spending due to rapid population aging, continuous expansion of

the fiscal deficit entails risks. However, there is room to pursue fiscal policy toward overcoming deflation, while maintaining medium- to long-term fiscal sustainability, by adjusting the pace of reducing the amount of fiscal deficit, or in other words, the pace of fiscal consolidation.

III. Opinions from Government Representatives

Ministry of Finance

- The government recently submitted the budget for fiscal 2018 and the supplementary budget for fiscal 2017 to the Diet.
- The budget for fiscal 2018 aims to achieve both economic revitalization and fiscal soundness. The government will work toward obtaining approval for the budget from the Diet at the earliest time in order to ensure a virtuous economic cycle and achieve sustainable economic growth.
- 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

- Going forward, the government will closely examine the progress in reforms at the Council on Economic and Fiscal Policy. In the basic policies for economic and fiscal management and reform to be completed this summer, it will show the timing of achieving a primary surplus and its plan to underpin the achievement.
- The government expects that the Bank will work steadily 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.