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June 25, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on June 14 and 15, 2018

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Going forward, it is likely to continue expanding, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending.
- Japan's economy is expanding moderately. With the output gap improving steadily, firms have been working on expanding the production capacity of their goods and services. It is important that such efforts continue, with somewhat tight supply-demand conditions being maintained.
- Although Japan's GDP growth rate for the January-March quarter of 2018 registered negative growth for the first time in nine quarters, this largely reflects temporary factors such as irregular weather. Firmness has been seen primarily in exports and private consumption since April, and the GDP growth rate is expected to return to positive territory.
- Japan's economy is expanding moderately. However, it is necessary to carefully monitor future developments, as some consumer sentiment indicators have been relatively weak of late and uncertainty regarding overseas economies recently has been heightening somewhat.

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.

- The effects of the U.S. protectionist trade policy on the global economy warrant close attention. Other concerns include the political situation in southern Europe and volatile movements in some emerging markets, although their effects on the global economy have been limited at this point.

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.
- There has been an expansion in supply capacity such as through reviewing business models, with dissipation of the negative hysteresis that arose as a result of the past economic downturn. In the short term, such expansion in supply capacity has been working in the direction of easing the upward pressure on prices associated with an increase in demand.
- Although the unemployment rate stands at 2.5 percent, the inflation rate has not been rising. In addition, the number of those entering the labor market has been increasing in tandem with labor shortages. Judging from this situation, the structural unemployment rate may be around 2 percent.
- If wages do not rise in line with inflation, this would pose a burden on people. Close attention should be paid to developments in labor productivity and real wages, while taking into account mainly the effects of a reduction in overtime work hours under working-style reforms.
- In Japan, inflation expectations tend to decline when the actual inflation rate decreases. In addition, sluggishness in the economic growth rate diminishes the improvement in the output gap. Although the recent weakness in indicators is temporary and is projected to recover, it warrants careful attention.
- The upward pressure on wages has been weak despite the increased tightness in the labor market, and firms also have remained cautious in their wage setting. Therefore, it is likely that achieving the price stability target will still take time. At the next MPM, when the July *Outlook for Economic Activity and Prices* (Outlook Report) will be published, it will be necessary to deepen analysis and discussion on prices.

- In view of the next Outlook Report, it is necessary to thoroughly analyze once again the background to the recent weakness in wages and prices as well as its effects on inflation expectations.
- In judging the inflation momentum, it is important to examine the aggregate supply-demand balance and firms' behavior comprehensively from every perspective.
- Developments in the output gap and inflation expectations are important in judging the momentum toward achieving the price stability target. The output gap implies an excess demand but it is not clear whether the gap has been improving. Also, inflation expectations have been sluggish. Thus, the momentum cannot be judged as having strengthened recently.
- The momentum toward achieving the price stability target of 2 percent is maintained, as evidenced by the year-on-year rate of increase in prices of dining-out and delivery services accelerating steadily, mainly on the back of a rise in wage costs.

II. Opinions on Monetary Policy

- Considering that there is still a long way to go to achieve the price stability target of 2 percent, it is appropriate to pursue powerful monetary easing with persistence under the current guideline for market operations in order to firmly maintain the momentum toward achieving the price stability target.
- The Bank should continue with the current monetary policy stance 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, the Bank should persistently continue with powerful monetary easing in a sustainable manner.
- Since the reason for the sluggishness in prices is unlikely to be merely a shortage of demand, it is not appropriate to adopt a policy that would forcibly push up demand in a short period of time. It is important to persistently maintain the current accommodative financial conditions, and to this end, the Bank should conduct monetary policy by giving due consideration to its sustainability while making sure that severe distortions do not arise in the economic and financial conditions.
- Financial institutions are faced with a rise in unrealized losses on securities and risks of impairment losses at branches with low profitability. In continuing with the current monetary

policy, it is necessary to take into account the two time frames in which its positive effects and side effects appear and consider the possible countermeasures against the side effects before they materialize.

- Some argue that a low interest rate impairs the functioning of financial intermediation through a deterioration of financial institutions' profitability, and thereby undermines monetary easing effects. The core function of financial intermediation is taking deposits and lending funds while taking into account the probability of repayments of the loans. Considering that the average loan-to-deposit ratio of domestic banks is 70 percent or less and the rest is invested in bonds, there may be room for improvement in banks' financial intermediation function.
- In the recent Japanese government bond (JGB) market, market participants' responsiveness to developments in mainly U.S. interest rates has been decreasing, and there have been days when inter-dealer transactions of newly issued bonds were not concluded. It is important to conduct market operations with a view to maintaining the functioning of financial markets as much as possible.
- The purchases of risky assets including exchange-traded funds (ETFs) are carried out as part of the policy package aiming at achieving the price stability target, and their policy effects and the possible side effects should continue to be examined from every angle.
- In other advanced economies where inflation of around 2 percent is a given, nominal growth rates of around 3 to 4 percent have been achieved. The price stability target of 2 percent demonstrates to the global community Japan's determination to achieve the same level of nominal growth as other advanced economies.
- Considering that inflation expectations are not rising easily, it is desirable, when necessary, to make efforts to improve communication and enhance the commitment in a broad sense toward achieving the price stability target of 2 percent, with a view to managing the expectations of private entities.
- Since the inflation rate has not been rising recently, inflation expectations have been sluggish. There needs to be an additional commitment that influences inflation expectations. Inflation expectations have been more or less unchanged despite the fact that the description on the timing of reaching around 2 percent inflation was deleted from the April 2018 Outlook Report. This may indicate that the current commitment is not functioning sufficiently.

- The Bank's commitment to achieving the price stability target of 2 percent at the earliest possible time has not changed at all, although the description related to the outlook for prices was reviewed. Market developments since the previous MPM suggest that this review was not perceived as a weakening of the Bank's commitment.
- It is of great significance that the commitment to the joint statement of the government and the Bank on overcoming deflation and achieving sustainable economic growth was reconfirmed upon the reappointment of Governor Kuroda. It is important to gain understanding that the government and Bank's commitment specified in the joint statement is firm.

III. Opinions from Government Representatives

Ministry of Finance

- The Basic Policies on Economic and Fiscal Management and Reform 2018 is scheduled to be decided by the Cabinet swiftly upon approval of the ruling party today.
- The Basic Policies presents concrete and highly effective plans for achieving fiscal soundness, and the government will continue to work toward achieving both economic revitalization and fiscal soundness.
- The government expects the Bank to continue to work toward achieving the price stability target under "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- The government will compile today the Basic Policies on Economic and Fiscal Management and Reform 2018 as well as the Investments for the Future Strategy 2018. The Basic Policies will specify that it will work on "Human Resources Development" and "Supply System Innovation," proceed with accepting foreign personnel with specialized and technical skills in consideration of the acute labor shortage, and aim at achieving a primary balance surplus for the national and local governments by fiscal 2025.
- The government expects the Bank to steadily pursue monetary easing toward achieving the price stability target, in light of developments in economic activity and prices, as well as financial conditions.