Not to be released until 8:50 a.m. Japan Standard Time on Monday, February 8, 2016.

February 8, 2016

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]

on January 28 and 29, 2016

I. Opinions on Economic and Financial Developments

Global Financial Markets and Risks

- Recently, financial markets have been volatile against the backdrop of the further decline in crude oil prices and uncertainty over future developments in emerging and commodity-exporting economies, particularly the Chinese economy. For these reasons, there is an increasing risk that conversion of the deflationary mindset might be delayed and that the underlying trend in inflation might be negatively affected.

- The Bank should be vigilant against negative effects on business confidence and consumer sentiment in Japan of heightened uncertainty over future developments in emerging and commodity-exporting economies and of the decline in crude oil prices. In particular, since Japanese firms' deflationary mindset has not been dispelled completely, due attention needs to be paid to risks that a rise in wages might not spread further and that the pace of increase in inflation might be negatively affected.

- The sharp decline in crude oil prices and volatile developments in global financial markets since the turn of the year suggest that a downside risk to the global economy is increasing. This could lead to the risks of a delay in conversion of firms' and households' deflationary mindset and of the underlying trend in inflation being negatively affected.

- There is a feedback loop between the real economy and financial markets in which conditions in the real economy are reflected in turbulence in financial markets, which affects the real

---

[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.

economy and inflation expectations. Against this backdrop, there is a possibility that the timing of achieving the price stability target of 2 percent will be further delayed. In fact, some price indicators imply this possibility.

- There is a possibility that the Organization of the Petroleum Exporting Countries (OPEC) and Russia will reach a deal to cooperate on production cuts in crude oil.

Economic Developments

- Japan's economy has continued to recover moderately with a virtuous cycle from income to spending operating.

- Japan's economy has continued to recover moderately, although effects of the slowdown in emerging economies have been seen. I project that Japan's economy will continue to grow at a pace above its potential in fiscal 2015 and 2016, and it is likely to maintain its positive growth in fiscal 2017, although with a slowing in its pace to a level somewhat below the potential growth rate due to the effects of the consumption tax hike.

- There is a possibility that the pace of increase in industrial production will slow down in and after the April-June quarter of 2016 due to a dissipation of the effects of the introduction of new cars to the market and to weaker-than-expected sales of new models of smartphones.

Prices

- The underlying trend in inflation has been rising steadily so far.

- The current low inflation rate is not a reflection of firms' deflationary price-setting behavior.

- The output gap and inflation expectations, which are determinants of the underlying trend in inflation, have been exerting upward pressure on prices. Although the inflation rate is likely to rise going forward, I project that the timing in which it will reach around 2 percent will be delayed to fiscal 2017 or thereafter, due mainly to the effects of the decline in crude oil prices.

- I expect that the timing of the inflation rate approaching around 2 percent will be around the first half of fiscal 2017.

- I consider it appropriate to give a wider time span for the projected timing of the year-on-year rate of increase in the consumer price index (CPI) reaching around 2 percent by indicating that it is projected to be "in fiscal 2017."

- Since it seems that a smaller number of firms are planning to raise sales prices than at around this time last year, there is a risk that the year-on-year rate of increase in the CPI (all items less fresh food and energy) around the April-June quarter of 2016 will come in lower than previously projected.

- Since the break-even inflation (BEI) rate for inflation-indexed Japanese government bonds (JGBs) is not reliable, we should put less emphasis on this in assessing inflation expectations.

II. Opinions on Monetary Policy

- Against the backdrop of volatile developments in global financial markets and other factors, there is an increasing risk that an improvement in the business confidence of Japanese firms and conversion of the deflationary mindset might be delayed and that the underlying trend in inflation might be negatively affected. It is necessary to preempt the manifestation of this risk.

- In order to maintain momentum toward achieving the price stability target of 2 percent, the Bank should introduce "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate."

- The Bank should implement additional easing measures in order to preempt the manifestation of risks and to maintain momentum toward achieving the price stability target of 2 percent.

- Now is the defining moment for Japan's economy to maintain momentum so as not to halt the virtuous cycle. The Bank should reinforce QQE and increase available options for further easing in the future by implementing additional measures in order to sustain credibility for monetary policy.

- I have argued that, in theory, the Bank could strengthen a portfolio rebalancing effect and enhance the effects of monetary easing through cutting its deposit rate on current accounts while maintaining the size of quantitative easing.

- With regard to tools for additional easing, there are three possible options: quantitative easing, qualitative easing, and an interest rate cut. Pros and cons of a further cut in the interest rate have been widely discussed. However, in light of experiences in some European countries, the Bank has gained enough knowledge about the effects and operational issues associated with negative interest rates to appropriately implement this policy.

- "QQE with a Negative Interest Rate" will enable the Bank to demonstrate that there is plenty of room for pursuing additional easing in terms of three dimensions: quantity, quality, and the interest rate.

- "QQE with a Negative Interest Rate" is expected to bring about a further decline in expected real interest rates by lowering the short end of the yield curve, in combination with large-scale purchases of JGBs.

- The Bank can strengthen monetary easing effects while avoiding undue burdens on financial institutions by adopting a multiple-tier system in which it will apply a negative interest rate not to the whole current account balance, but to that in excess of certain thresholds.

- The multiple-tier system is designed to lower a marginal interest rate into negative territory while ensuring that financial institutions' functions as financial intermediaries will not be impaired due to an excessive negative impact on their earnings.

- Although risks are tilted to the downside due to volatile developments in global financial markets, an immediate policy response is not necessary in this situation. I am concerned that the introduction of a negative interest rate may give an impression to the market that the Bank's monetary policy is approaching its limit.

- Japan's economic activity and its underlying trend in inflation have not deteriorated. Given the current accommodative financial conditions, additional easing measures are not warranted. Thus, the Bank should maintain its current monetary policy. If the Bank were to introduce a negative interest rate immediately after the introduction of supplementary measures for QQE, this might be misunderstood as approaching a limit to its asset purchases. Also, since a complex policy framework proposed at this meeting could cause confusion, it could reduce monetary easing effects.

- Given the current situation, I do not think this is the time to drastically change monetary policy. Financial institutions' rebalancing of their portfolios, which the Bank's large-scale purchases of JGBs intend to induce, is likely to result merely in an increase in current account balances in exchange for JGBs. There is limited room for the private sector's borrowing rates to decline further in response to an additional decrease in JGB yields, and thus business fixed investment is unlikely to increase.

- Japan's economic activity and prices have maintained stable conditions, and the recent instability in financial markets has not been serious. At this moment, the Bank does not need to implement additional monetary easing. The introduction of a negative interest rate would cause the following problems: it would affect the stability of the Bank's JGB purchases, since it would reduce financial institutions' incentive for selling JGBs to the Bank, and it could lead to an increase in potential instability of the financial system as a result of further decreases in financial institutions' profitability. This policy measure would only be appropriate in a crisis situation. The Bank should refrain from implementing it at this moment.

- Maintaining the current pace of increase in the monetary base and introducing a negative interest rate at the same time lacks logical consistency. A negative interest rate should be introduced when the Bank slows down the pace of increase in the monetary base -- that is, tapers its asset purchases. The introduction of a negative interest rate will have larger side effects on the functioning of financial markets and the financial system than positive effects on the real economy. Thus, in this policy measure, side effects outweigh positive effects.

- Looking ahead, I am concerned that financial markets would expect further cuts in the interest rate into negative territory, leading to confusion and anxiety among financial institutions and depositors. Since the public does not necessarily understand well why the Bank aims at achieving the price stability target of 2 percent, the introduction of this policy measure could aggravate misunderstanding.

- I am concerned that the Bank's introduction of a negative interest rate could lead to a competition with central banks in other countries, which already have adopted negative interest rates, to lower interest rates deeper into negative territory. As medium- to long-term JGB yields become negative, there is an increasing risk that only the Bank may become the ultimate buyer of JGBs and that market participants will regard the Bank's JGB purchases as deficit-financing.

- I oppose revising the expression that "It [the Bank] will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" in this Monetary Policy Meeting's statement because I understand that this expression takes into account the prudential aspects.

III. Opinions from Government Representatives

Ministry of Finance

- We regard the measures proposed by the Bank's staff at this meeting as necessary for achieving the target of monetary policy.
- The government expects the Bank to continue to thoroughly and actively explain the situation of its monetary policy management, including the measures proposed at this meeting.
- The supplementary budget for fiscal 2015 was approved by the Diet recently, and the budget for fiscal 2016, with a view to achieving both economic revitalization and fiscal consolidation, was submitted to the Diet.
- The government continues to expect the Bank to work toward achieving the price stability target in light of economic activity and prices.

Cabinet Office

- In assessing price developments, it is important to comprehensively examine a wide range of price indicators, including the implicit price deflator of gross domestic product (GDP deflator).
- The government expects that the Bank will steadily work toward achieving the price stability target of 2 percent in light of economic activity and prices.
- The government considers it necessary to pay close attention to the effects of monetary policy, including the additional easing measures decided at this meeting.
- We consider it important that the Bank will fully explain to the public its thinking about the changes made to the projected timing of achieving the price stability target and the monetary policy framework.