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March 24, 2016

Bank of Japan

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

on March 14 and 15, 2016

I. Opinions on Economic and Financial Developments

Global Financial Markets and Risks

- Global financial markets have somewhat regained their calmness on the back of the favorable U.S. economic indicators, a rebound in crude oil prices, and the fact that the Group of Twenty (G-20) reached a shared understanding on collective and individual use of all policy tools.

- Since mid-February, global financial markets have started to regain a measure of calm following the fluctuations observed since the turn of the year.

- Although the volatile movements in global financial markets have abated, risks to the outlook for domestic and overseas economies continue to be tilted to the downside.

- Although global financial markets have been volatile since the turn of the year, the real economy has been benign thus far. Going forward, a risk that volatile financial markets might have adverse effects on Japan's economic activity warrants attention.

Economic Developments

- Japan's economy has continued its moderate recovery trend.

- Japan's economy has been on a recovery trend, although exports and production have been weak.

[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.

- There is a concern that weakness in exports and production, as observed in their indicators, might affect business fixed investment.
- In projecting developments in economic activity and prices, it is necessary to fully examine what has brought weakness to private consumption.
- Private consumption has been weak despite a steady increase in household income, and this might be attributable to an increasingly defensive attitude of consumers, including pensioners, toward spending.
- An increase in base pay at major firms, which exerts a large impact on future developments in the underlying trends in prices and private consumption, will likely be relatively smaller than that of last year.
- It is vital for Japan to take measures to expand domestic demand and boost its growth potential amid changes in the global demand structure, such as a slowdown in the Chinese economy.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is likely to be about 0 percent for the time being but is expected to reach 2 percent around the first half of fiscal 2017 given that crude oil prices stopped declining in mid-February.
- The CPI inflation is likely to head toward 2 percent -- the price stability target -- although there remain risks such as a decline in crude oil prices and weakening in inflation expectations.
- Firms' moves to raise wages have been feeble, and indicators for inflation expectations have been declining.
- The probability has declined that the year-on-year rate of change in the underlying trend in inflation will remain in the range of 1.0-1.5 percent from early spring.

II. Opinions on Monetary Policy

Overall Assessment of Developments since the Bank's Decision to Introduce "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate"

- The policy effects on interest rates already have been seen, as evidenced by clear declines in a benchmark rate for lending to firms and in interest rates on housing loans since the Bank's decision to introduce "QQE with a Negative Interest Rate."

- "QQE with a Negative Interest Rate" has exerted its intended effects in that it lowered interest rates.

- Under "QQE with a Negative Interest Rate," the funding cost of firms and households has declined to a very low level, and financial conditions are highly accommodative.

- A decline in interest rates on housing loans will stimulate housing investment and decrease borrowers' burden of paying interest rates through refinancing, and thus exert positive effects on private consumption.

- Some argue that "QQE with a Negative Interest Rate," which the Bank decided to introduce last January, is not producing the effects of stimulating demand and raising inflation since stock prices declined and the yen appreciated further even after the decision. However, it will likely exert the intended effects as global financial markets regain their calmness.

- Given the weak economic indicators published recently, the introduction of "QQE with a Negative Interest Rate" at the previous meeting was the right decision.

- It is essential for the Bank to steadily pursue the current monetary policy, aiming to achieve the price stability target of 2 percent at the earliest possible time.

- In consideration of the volatility in global financial markets, the Bank should continue to pursue "QQE with a Negative Interest Rate" while paying due attention to developments in economic activity, prices, and financial markets.

- The Bank should take additional easing measures in terms of three dimensions -- quantity, quality, and the interest rate -- if it is judged necessary.

- Undoing the negative interest rate policy is not an option because the markets have started to take actions and many economic entities already have moved forward based on the policy.

- Withdrawal from the Bank's negative interest rate policy is preferable. However, there is a risk that a withdrawal from the policy soon after its introduction will confuse the markets and impair the credibility of the Bank. The Bank should keep the current policy on hold unless the advantage of further easing can be observed clearly.

- Considering that side effects of the policy outweigh its positive effects, I propose to bring the policy rate back to 0.1 percent, while maintaining the three-tier system applied to current accounts at the Bank in order to be prepared for the future exit.
- When judging real interest rates, interest rates on private assets, which influence the private sector's economic activity, rather than those on Japanese government bonds (JGBs), should be used as benchmarks.
- Portfolio rebalancing has not necessarily exerted its intended effects, since alternative financial assets in the domestic market in which to invest are limited.
- All the risks I pointed out as side effects of the negative interest rate -- namely, a misunderstanding that the Bank's purchase of JGBs has reached its limit, anticipation of further rate cuts by market participants, concern and anxiety among financial institutions and depositors leading to a misunderstanding over the price stability target of 2 percent, and the complex structure of the measures diminishing policy effects -- have manifested themselves.
- Considering the limited room for additional monetary policy measures that are likely to exert positive effects that outweigh their side effects, it is most important to maintain the liquidity of the JGB market and stability of interest rates, and to secure effects of the policy to date. The decrease in the amount of JGBs to be purchased contributes to maintaining the effects of the policy to date.
- The Bank's price stability target of 2 percent should be interpreted flexibly.

Effects on the Functioning of Financial Intermediation

- The Bank should explain that "QQE with a Negative Interest Rate" will exert positive effects on financial institutions' profits by improving the economy as a whole.
- Overcoming deflation will lead to a significant improvement in banks' profits. In fact, since the introduction of QQE, current profits of the banking sector as a whole have been increasing significantly.
- It is understandable that banks are unhappy with the flattening of the yield curve resulting from the additional monetary easing, as they make profits from the differential between long-

and short-term interest rates. However, if this differential is the only source of their profit, banks are not adequately performing their function as financial intermediaries.

- In a situation of negative interest rates, financial institutions may try to reduce the size of their balance sheet, resulting in credit contraction.

- The Bank's negative interest rate policy would have a negative impact on the economy due to an impairment of the functioning of financial intermediation, and would heighten the risk of accumulation of financial imbalances. In addition, it would increase people's anxiety, exacerbating their deflationary mindset.

- The Bank's monetary policy measures to date, including the negative interest rate policy, have increased potential vulnerability in the financial system. It is the time for the Bank to rebalance its policy by shifting the emphasis from price stability to financial system stability.

Others

- It is a responsibility of the Bank as a monetary policy authority to continue to enhance and devise policy measures, just as it decided on operational details at this round of the MPM, in order to maximize the easing effects of "QQE with a Negative Interest Rate."

- The special treatment that was introduced this time may send a signal that the Bank has reached the limit of negative interest rate policy, which could increase market volatility. Now that many market participants are anticipating additional easing, the Bank's communication with the market has become quite complicated.

- The Bank needs to explain patiently and promote understanding among the general public regarding the wide variety of benefits that "QQE with a Negative Interest Rate" will bring about for the economy as a whole, instead of focusing on gains and losses stemming from transactions with financial institutions.

- I realize that influencing people's expectations is complicated, as some people feel uneasiness about the negative interest rate.

- The Bank's policy decisions surprised the market, blurring its policy reaction function and exacerbating volatile market movements.

- We should closely monitor the adverse effects on the economy brought about by the larger fluctuations in financial markets that had been resulting mainly from the sharp decline in trading activity in those markets and the rise in volatility in the JGB market, both of which have taken place since the Bank's decision to introduce the negative interest rate policy.

III. Opinions from Government Representatives

Ministry of Finance

- At the G-20 Finance Ministers and Central Bank Governors Meeting in February, points that the Japanese government considers crucial were included in the communiqué. The Japanese government, in close cooperation with relevant foreign authorities, will carefully monitor developments such as those in financial markets.

- In order to further promote the overcoming of deflation and economic revitalization, the government will swiftly and steadily implement the supplementary budget for fiscal 2015, and at the same time work toward obtaining approval from the Diet for the budget for fiscal 2016 and related bills at the earliest possible time.

- 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 the gross domestic product (GDP deflator), which measures prices of value-added.

- 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 expects the Bank to continue to thoroughly communicate on its negative interest rate policy, and also expects that the Bank will make efforts such that its policy effects will be fully realized.