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June 24, 2016
Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on June 15 and 16, 2016

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has continued its moderate recovery trend, with a virtuous cycle from income to spending operating, although exports and production have been sluggish.
- Japan's economy has maintained its moderate recovery trend. Business fixed investment has been on a moderate increasing trend. Private consumption has been more or less flat, but is expected to edge up on the back of firm employment and income situation.
- Japan's economy has seen an uptick in the April-June quarter, as evidenced by production and consumption.
- Japan's economy is likely to be on a moderate expanding trend against the background of an improvement in the employment and income situation, but risks are skewed to the downside considering the weakness in private consumption, as well as the negative effects of the yen's appreciation, which are likely to become evident.
- The global economy and global financial markets going forward, developments in private consumption and firms' price- and wage-setting stance in Japan, and the impact on the economy and prices of deferring the timing of the consumption tax hike to 10 percent should be examined closely without preconception.

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 has been on a moderate recovery trend. Some weakness has been observed in private consumption, but this reflects a vague anxiety toward the future. Looking ahead, whether the United Kingdom will leave the European Union (EU) and the impact this would have on the global economy warrant attention.
- Depending on the result of the referendum on the United Kingdom's membership of the EU, there is a possibility that market volatility will increase sharply.
- Global financial markets are likely to shift somewhat to a "risk-off" mode for the time being, which conceivably could weigh on the economy both at home and abroad, mainly through increasing cautiousness in sentiment.

Prices

- The mechanism in which inflation rises moderately accompanied by wage increases has continued to operate.
- Inflation expectations have weakened somewhat but are projected to gradually see an acceleration in their rate of increase as the improvement in the output gap progresses on the back of tight labor market conditions and an uptrend in business fixed investment.
- Prices are expected to be low for the time being, in a situation where consumption is sluggish, and thus price hikes, similar to last year, cannot be anticipated, but prices will head toward an increase from the latter half of the fiscal year.
- While the pace of increase in goods prices has slowed, that in services prices has accelerated, and with the decline in the momentum of increases in goods prices, prices overall have been sluggish.
- Firms have strengthened their cautious stance toward raising prices again due to the pause in the depreciation of the yen and weakened private consumption.

II. Opinions on Monetary Policy

Effects of the Negative Interest Rate Policy

- Owing to the negative interest rate policy, not only Japanese government bond (JGB) yields but also lending rates, as well as issuing rates on CP and corporate bonds, have been declining considerably. Firms' funding conditions have become even more accommodative,

mainly evidenced by the amount of issuance of super-long-term corporate bonds having been increased.

- Despite remaining uncertainties over the global economy, business fixed investment has continued to be on an increasing trend and housing investment has resumed its pick-up. This shows that the effects of the negative interest rate policy have spread to the real economy gradually.
- The effects of a decline in interest rates brought about by "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate" are steadily spreading to economic activity and prices; business fixed investment has remained on a moderate increasing trend and the number of housing starts has resumed its pick-up, reflecting a decline in interest rates on housing loans.
- As the practice of financial transactions has been adjusted to reflect the adoption of a negative interest rate, firms' funding has continued smoothly. For instance, the issuance of corporate bonds based on absolute yield (rather than spread over the government bond yields) has become a common practice and the provision of syndicated loans with a fixed interest rate has been observed.
- The effects of the negative interest rate policy have not become clearly evident thus far, since the rate of increase in banks' lending as a whole has not accelerated. It is necessary to closely monitor the rapid increase in lending to the real estate sector from the perspective of financial system stability in the future.

Monetary Policy Management

- While effects of the negative interest rate policy already have been seen -- for example, declines in lending rates and an increase in the issuance of corporate bonds -- the Bank, for the time being, needs to examine the extent of the spread of policy effects to the real economy, and thus it is appropriate to maintain the current monetary policy.
- The Bank should continue with the current monetary policy. The policy effects of "QQE with a Negative Interest Rate" already have materialized in the form of a decline in interest rates. Going forward, the effects will gradually spread to economic activity and prices even though this will take some time.

- Considering that there is a time lag before monetary policy can produce effects, the Bank should examine the effects of the negative interest rate policy on economic activity and prices at this point in time. Moreover, it is necessary to carefully monitor the result of the referendum on the United Kingdom's membership of the EU and subsequent financial and economic developments.
- Looking ahead, the underlying trend in inflation is likely to rise, although risks to this outlook are tilted to the downside. In order to prevent Japan's economy from returning to deflation, the Bank should patiently and resolutely continue to pursue monetary policy that aims to achieve the price stability target of 2 percent.
- The Bank should consider additional monetary easing measures if judged necessary for stabilizing the macroeconomy and achieving the price stability target.
- There are signs of a need for caution with respect to achieving the price stability target, such as weaker developments both in the year-on-year rate of increase in the consumer price index (CPI) excluding fresh food and energy and in inflation expectation indicators. If it becomes more likely that the timing of annual CPI inflation reaching around 2 percent will be delayed, the Bank will need to reiterate its commitment toward achieving 2 percent inflation to the public and market by taking additional monetary easing measures.
- I expect the government's structural reforms to be steadily implemented by taking advantage of the current accommodative financial conditions.
- Economic developments after the introduction of QQE should be assessed based on nominal GDP and the GDP deflator. The GDP deflator measures prices of domestic value-added, which subtract changes in import prices. After the introduction of QQE, nominal GDP and the GDP deflator increased by 1.8 percent and 0.9 percent annually (adjusted to exclude the estimated effects of changes in the consumption tax rate), respectively. Given that the corresponding figures were negative before the introduction of QQE, the effects of QQE are obvious.
- The Bank cannot continue with the current pace of JGB purchases for long. Before its JGB purchases face obstacles, they need to be modified to more sustainable ones.
- The Bank should change the current policy framework -- in which the target should be achieved within a short period of time -- to one that is suitable for a protracted duration. My understanding is that the main aim of the Bank's policy already has shifted from quantitative

easing to lowering interest rates. Given the substantial effects of lowering interest rates, in order to ensure durability of the current policy, the Bank needs to consider how the quantitative commitment can be phased out smoothly.

- The Bank should review the current policy of its massive scale of JGB purchases, since this undermines the credibility of both fiscal and monetary policies. Purchasing JGBs at prices deviating from those prevailing in the market eventually will result in losses for the Japanese people.
- Policy decisions that intend to surprise the market are likely to reduce the predictability of monetary policy significantly, and thereby lessen policy effects through higher volatility in the market. The Bank should normalize communication with the market and enhance two-way dialogues as soon as possible.
- Portfolio rebalancing has induced a large amount of funds to invest in currency-hedged foreign bonds amid sluggish demand for borrowing, resulting in an increase in the U.S. dollar funding premiums. In this situation, investment profits have transferred from Japanese investors to foreign investors. This could be regarded as the effects of monetary easing having spilled over to overseas through lowering yields on foreign bonds.
- I do not understand why some argue that a bank's reluctance to purchase JGBs, which has been reported in the news media recently, is an indication of QQE's limits or its side effects. If financial institutions that held JGBs would instead increase domestic and overseas lending or various asset classes other than JGBs, this should produce effects of monetary easing on the real economy. Such behavior by financial institutions should be regarded as an indication of the spread of policy effects to the economy.

III. Opinions from Government Representatives

Ministry of Finance

- Given the agreement reached and shared awareness of risks at the Group of Seven (G-7) meeting held in May, the government decided to postpone the consumption tax hike while using all policy tools, including accelerating structural reforms and implementing fiscal policy.
- Meanwhile, the government will maintain its goal of generating a surplus in the primary balance for fiscal 2020 without lowering the flag of attaining fiscal soundness. It also will

steadily implement expenditure reform with no exceptions while promoting economic revitalization.

- 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 GDP deflator.
- The Cabinet recently decided the Basic Policies 2016, which includes postponing raising the consumption tax rate to 10 percent until October 2019 and compiling a set of comprehensive and bold economic measures by this autumn. It also decided the Japan Revitalization Strategy 2016 and Japan's Plan for Dynamic Engagement of All Citizens.
- 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.