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August 8, 2016

Bank of Japan

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

on July 28 and 29, 2016

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has generally continued its moderate recovery trend, although exports, production, and some indicators of private consumption have shown relatively weak developments.

- Japan's real economy has maintained its resilience. A virtuous cycle from income to spending has been neither strengthened nor impaired.

- Japan's economy has continued its moderate recovery trend. A virtuous cycle from income to spending in the corporate sector has been operating. However, concerns about stagnancy in the cycle from income to spending in the household sector and about the effects resulting from the United Kingdom's vote to leave the European Union (EU) -- the so-called Brexit -- warrant attention.

- The government's stimulus package is likely to be extremely large in scale, which will considerably push up the growth rate and inflation rate.

- Comparing the projections in the July 2016 *Outlook for Economic Activity and Prices* (Outlook Report) with the previous ones, the projected growth rates are higher, due in part to the effects of economic stimulus measures by the government.

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[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 stagnant, but is likely to turn to a moderate uptrend, partly owing to the effects of economic stimulus measures by the government.
- The June 2016 Short-Term Economic Survey of Enterprises in Japan (*Tankan*) showed resilience in business fixed investment, but this was based on the predicted exchange rate of 111.41 yen against the U.S. dollar, which implies that the recent appreciation of the yen was not taken into consideration. Looking at machinery orders, which is a leading indicator of business fixed investment, it is hard to say that business fixed investment has been steady. A rise in corporate profits seems to have paused, even with the problem that the pace of increase in investment is relatively slow in light of high profits.
- After the referendum in the United Kingdom, a situation where market sentiment is prone to become unstable will be prolonged for certain.
- Uncertainties surrounding overseas economies have been heightened, reflecting Brexit and the slowdown in emerging economies.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is projected to reach around 2 percent during fiscal 2017, although this is accompanied by considerable uncertainties including those surrounding overseas economies going forward.
- The inflation rate is likely to accelerate toward 2 percent, but uncertainties are considerable. There is a risk that a rise in inflation expectations will be restrained.
- The inflation rate is expected to rise at a gradual pace, as the output gap has been on an improving trend and inflation expectations have maintained their uptrend from a longer-term perspective. The timing of the inflation rate reaching around 2 percent is projected to be around the second half of fiscal 2017.
- It is less likely that inflation expectations will rise rapidly, and thus it is projected that the inflation rate will not reach 2 percent in fiscal 2017.
- The decline in medium- to long-term inflation expectations results from a normalization, in which they see a temporal rise followed by a return to the equilibrium rate, and should not be taken as an increase in deflationary risk.

II. Opinions on Monetary Policy

Enhancement of Monetary Easing

- In order to respond to the recent increase in uncertainties surrounding overseas economies, such as Brexit, it is appropriate for the Bank to support the private sector's proactive economic activities by adopting measures to ensure smooth funding in foreign currencies by Japanese firms and financial institutions as well as by doubling the amount of the Bank's exchange-traded fund (ETF) purchases.

- The Bank should make the utmost effort to prevent uncertainties brought by overseas economies from leading to a deterioration in firms' and households' sentiment. The most effective measure for that purpose is the Bank's purchases of ETFs. The Bank should dare to double the amount of the purchases.

- Since uncertainties brought by overseas economies seem to be affecting business and consumer sentiment, monetary easing measures that aim to influence asset prices -- such as doubling the amount of ETF purchases to 6 trillion yen annually -- would be effective.

- I support the introduction of the measures to ensure smooth funding in foreign currencies, because these measures will dispel a concern over funding in foreign currencies and thus promote proactive economic activities.

- The measures to ensure smooth funding in foreign currencies by Japanese firms and financial institutions and an increase in the Bank's ETF purchases are appropriate in order to address uncertainties surrounding overseas economies and heightened cautiousness in firms' and households' sentiment.

- Highly accommodative financial conditions are maintained. In this situation, a further increase in ETF purchases is a policy option that can prevent a deterioration in households' and firms' sentiment.

- In light of recent developments such as a slowing pace of increase in the CPI (all items less fresh food and energy) and weakening in various indicators for inflation expectations, the Bank should implement additional monetary easing in order to ensure that the price stability target of 2 percent will be achieved during fiscal 2017.

- Uncertainties surrounding overseas economies, such as Brexit, are likely to remain elevated. In light of the slowing of the year-on-year rate of increase in the CPI and of weakening of inflation expectations in Japan, the Bank should adopt additional monetary easing measures in order to fully prepare for downside risks to the economy.

- As downward pressures on prices, partly stemming from exchange rate movements, are expected to continue, risks to the outlook for prices are skewed to the downside. Under these circumstances, persistent monetary accommodation is warranted. Against this backdrop, I will support the enhancement of monetary easing.

- The annual purchase of ETFs of 6 trillion yen would be excessive, as purchases in such large amounts distort the pricing mechanism in the stock market and make the Bank's exit policy more difficult. It also raises concern over an adverse impact on the Bank's financial soundness.

- An increase in the Bank's ETF purchases would make it clear that monetary easing is approaching its limit. Moreover, this action can be regarded as an incremental approach to monetary easing, and there is a risk of triggering endless expectations for further monetary easing.

- I do not support an increase in the Bank's ETF purchases for the following reasons: (1) the economic conditions do not warrant further monetary easing; (2) the increase distorts the market mechanism and leads to a rise in volatility; (3) it further impairs the Bank's financial soundness; and (4) it gives a wrong impression that the Bank targets stock prices. Rather, it is appropriate for the Bank to reduce the amount of its ETF purchases.

Synergy Effects of Monetary Policy and the Government's Initiatives

- A combination of the government's fiscal expansion and the Bank's monetary easing aimed at achieving the price stability target is widely known as a "policy mix." In this "policy mix," the impact of the fiscal stimulus will be further strengthened. The Bank welcomes the government's stimulus package, as it is very timely.

- The government's stimulus package, which is being formulated, seems to be harmonious with the Bank's monetary easing.

- By enhancing monetary easing, the Bank can demonstrate its stance to work closely with the government.

Comprehensive Assessment

- The Bank should conduct a comprehensive assessment of the developments in economic activity and prices and the policy effects since the introduction of Quantitative and Qualitative Monetary Easing (QQE) at the next MPM, with a view to achieving the price stability target of 2 percent at the earliest possible time.

- Japan's economic activity and prices have improved substantially over the last 3 years. However, the price stability target has not yet been achieved. It is necessary for the Bank to conduct a comprehensive assessment from the perspective of what should be done to achieve the price stability target of 2 percent at the earliest possible time.

- In planning policy actions to achieve the price stability target, a comprehensive assessment of the developments in economic activity and prices as well as of the policy effects since the introduction of QQE is essential at the moment.

Others

- The Bank should reject the idea that monetary easing has its limit and side effects. A limit to the Bank's purchase of Japanese government bonds (JGBs), if any, would be the total amount outstanding of JGBs issued. Moreover, some argue that the possibility of the Bank's loss due to a rise in interest rates during the process of an exit from monetary easing could set a limit to monetary easing. However, this argument makes no sense as the Bank's profit increases during the period of quantitative easing and will increase over the longer term due to the rise in interest rates.

- Given that the Bank's monetary policy measures are very aggressive and powerful, the Bank should provide more detailed and articulate explanations than before, thereby making sure that the policy measures have their intended effects.

- While positive impacts of a decline in super-long-term interest rates on business fixed investment are limited, there are adverse impacts such as those on business firms' balance sheets due to lower discount rates for pension liabilities, as well as on lower expected returns for public pensions. In addition, a concern over the sustainability of the social security system may lead to deterioration in the public's confidence.

- With life insurers matching assets and liabilities, trading liquidity in the super-long-term JGB market has declined significantly amid a tightening of its supply and demand conditions, entailing the risk that volatility in the market will be heightened. This clearly suggests an increasing difficulty in terms of the Bank's JGB purchases, which is a precursor of what will happen in JGB markets with various maturities.

III. Opinions from Government Representatives

Ministry of Finance

- The government recognizes that the proposals presented by the Bank's staff at this meeting are necessary for the Bank to achieve the goal of monetary policy while taking risks about the global economy into consideration, and would like to welcome them.

- In response to the United Kingdom's vote to leave the EU, it is vital to closely monitor the effects on the real economy in the medium to long term.

- The government is currently compiling comprehensive and bold economic measures.

- The government continues to expect the Bank to work toward achieving the price stability target in light of economic activity and prices.

Cabinet Office

- Given the instructions from the prime minister, the government is eagerly making efforts to compile the comprehensive and bold economic measures.

- 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 deems it necessary to closely monitor the effects of monetary policies, including additional easing measures decided at this meeting. The government also deems it important that the Bank will fully explain to the public its thinking on the changes in monetary policy.