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September 30, 2016

Bank of Japan

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

on September 20 and 21, 2016

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has continued its moderate recovery trend, but the year-on-year rate of change in the consumer price index (CPI) is on a declining trend as relatively weak developments have been observed in some indicators of private consumption.

- Japan's economy has continued its moderate recovery trend. Although the virtuous cycle in the economy has been maintained, it should be noted that firms' and households' sentiment are somewhat subdued.

- Japan's economy has continued its moderate recovery trend, although exports and consumption have weakened.

- The current fall in the propensity to consume is partly attributable to the subsequent decline in durable consumer goods demand that was stimulated by the measures implemented after the global financial crisis.

- It is a relief that households' and firms' sentiment has remained stable amid high uncertainty, mainly associated with overseas economies.

- High uncertainties surrounding the global economy are likely to remain for the time being.

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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.

Prices

- Commodity prices have been fluctuating within a certain range -- albeit at a low level -- and the downward pressure on consumer prices is likely to gradually dissipate. Inflation expectations have maintained their uptrend in the somewhat longer term, but attention needs to be paid to inflation expectations having been under strong downward pressure through an adaptive formation mechanism.

- In combination with monetary easing measures, the government's large-scale stimulus package that are to be implemented are expected to contribute to a rise in the economic growth rate and an improvement in inflation expectations.

- The recent decline in medium- to long-term inflation expectations can be regarded as an indication that the inflation expectations are reverting from a temporary rise to the equilibrium level that is consistent with the current economic structure.

II. Opinions on the "Comprehensive Assessment"

Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)

- The Bank's policy measures to date have had effects in that the economy is no longer in deflation, which is generally defined as a sustained decline in prices.

- In Japan, the adaptive component plays a relatively large role compared to other countries in the formation of inflation expectations, and therefore measures to strengthen the forward-looking expectations formation mechanism are warranted.

- The expansion of the monetary base, together with the commitment to achieving the price stability target and the Bank's purchases of Japanese government bonds (JGBs), has transformed peoples' perceptions of inflation and has led to a rise in inflation expectations.

- A long-run relationship between the monetary base and inflation expectations is not observed, while a short-run relationship may have appeared through an effect from foreign exchange rates.

The Effects and Impact of the Negative Interest Rate

- The negative interest rate policy, in combination with JGB purchases, has pushed down short- and long-term interest rates substantially. However, it should be noted that the impacts, such as on financial institutions' profits, financial markets, and the rates of return on life and pension insurance products, also have been substantial.

- Maintaining soundness of financial institutions in Japan is important from the perspective of global financial system stability.

- The effects of monetary easing should be analyzed in view of the following factors: (1) the impact on the profitability of financial institutions; (2) the impact of the lower profitability of financial institutions on the economy as a whole; and (3) the positive impact of monetary easing on the economy through channels other than financial intermediation. Among these, (2) and (3) are particularly important.

- If the economy as a whole improves, the profitability of financial institutions will also improve on the back of a decline in credit costs, an increase in nominal interest rates, and an expansion of lending.

- A decline in lending rates and a reduction of financial institutions' lending margins are not attributable merely to QQE but also to structural problems, such as a decline in the natural rate of interest, prolonged deflation, and excess saving in the corporate sector.

III. Opinions on Monetary Policy

General Remarks

- Amid considerable downside risks to prices, it is imperative to ensure the sustainability of monetary easing and thereby prevent Japan's economy from returning to deflation. Against this background, the Bank should adopt a new policy framework and implement necessary measures as appropriate.

- In order to achieve a sustainable increase in private consumption, the Bank should strengthen monetary easing based on the comprehensive assessment at today's MPM and exert upward pressure on wages together with the government's growth strategy.

- An "inflation-overshooting commitment" and "yield curve control" are consistent with monetary easing measures that the Bank has been implementing thus far. These measures are also a paradigm shift in monetary easing policy, which is appropriate in terms of achieving the price stability target at the earliest possible time.

- The Bank should continue to assess its effectiveness and side effects of the new policy framework. If judged necessary for achieving the price stability target of 2 percent, the Bank should respond flexibly, including modifications to the policy framework.

- A rise in the potential growth rate is essential for a rise in the natural rate of interest, thereby leading to the normalization of nominal interest rates. In this respect, the government's initiatives for strengthening Japan's growth potential are essential.

- In order to achieve the price stability target of 2 percent at the earliest possible time, it is essential to promote private demand by accelerating initiatives for strengthening Japan's growth potential in both the public and private sectors, supported by highly accommodative financial conditions. Gaining momentum toward an improvement in the growth potential will lead to a rise in inflation expectations.

Yield Curve Control

- Through the Bank's experience in conducting QQE, it is confirmed that a combination of a negative interest rate and JGB purchases has a considerable influence on the entire yield curve. The Bank should control the yield curve by setting a specified level of long-term interest rates, by taking account of its impact on financial institutions' profits.

- Compared with the previous policy framework, the new policy framework with yield curve control placed at the core will enable the Bank to make more flexible adjustments according to economic, price, and financial developments, and will enhance the sustainability of monetary easing.

- It is a natural consequence that the amount of the Bank's JGB purchases may fluctuate, either upward or downward, to achieve the target level of a long-term interest rate specified by the guideline for market operations decided at each MPM. The Bank should explain that such a change in the amount of purchases would have no policy implication.

- The current target level of 10-year JGB yields, which is around 0 percent, is set as an operating target for market operations for the intermeeting period. The Bank does not intend to peg 10-year JGB yields at this level for long in the future. It will examine an appropriate shape of the yield curve at every MPM.

- I basically support the shift in the operating target to short-term and long-term interest rates because this will enhance the sustainability of monetary easing. However, as the Bank would continue JGB purchases in line with the current pace under the new forward guidance, JGB yields would likely be held in negative territory up to a maturity of ten years, leading to concern over an adverse impact on the functioning of financial intermediation.

- It is uncertain whether the pace of JGB purchases will slow down as intended and the sustainability of monetary easing consequently improve under yield curve control. On the contrary, there would be a risk that the Bank might need to increase the pace of JGB purchases in response to a spike in long-term interest rates. Moreover, the introduction of new tools of market operations such as fixed-rate purchase operations is an extraordinary measure that entails a risk of impairing the functioning of financial markets significantly.

- The Bank should continue to use amounts of asset purchases as its operating targets and reduce the pace of its JGB purchases together with a modification to forward guidance. It is of utmost importance that, through these measures, the Bank enhances the sustainability of JGB purchases and the stability of the JGB market and thereby maintains the effects on the economy through the decline in long-term real interest rates to date.

Inflation-Overshooting Commitment

- In order to raise inflation expectations, the Bank should commit itself to expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds the price stability target of 2 percent and stays above the target in a stable manner.

- Considering that there is a time lag until monetary policy takes effect, the Bank will have an extremely strong commitment to continuing with monetary easing until the observed CPI inflation exceeds and stays above 2 percent.

- An inflation-overshooting commitment is not a realistic target and will not be effective for raising inflation expectations either.

IV. Opinions from Government Representatives

Ministry of Finance

- A new framework for strengthening monetary easing was proposed at this meeting. The government recognizes that the proposals are necessary in order to achieve the price stability target of 2 percent at the earliest possible time, and would like to welcome them.

- The government considers it important to work closely with the Bank and fully mobilize monetary policy, fiscal policy, and structural reforms.
- The government will make efforts fully to an earlier implementation of the supplementary budget and to pursue structural reform.
- The government continues to expect the Bank to work toward achieving the price stability target in light of developments in economic activity and prices.

Cabinet Office

- The government welcomes the Bank's "Comprehensive Assessment" as an extensive analysis on developments in economic activity and prices as well as policy effects since the introduction of QQE, and on the effects and impact of the negative interest rate.
- The government welcomes the measures introduced at this meeting as necessary ones proposed in order to achieve the price stability target. The government deems it important that the Bank will fully explain to the public its thinking on and results of the "Comprehensive Assessment."
- The government expects that the Bank will steadily work toward achieving the price stability target of 2 percent in light of developments in economic activity and prices.