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November 10, 2016

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on October 31 and November 1, 2016

I. Opinions on Economic and Financial Developments

Economic Developments

- Although exports and production, as well as some indicators of private consumption, have remained sluggish, Japan's economy has continued its moderate recovery trend, against the background that a moderate increase in business fixed investment and improvement in the employment and income situation have continued.
- Although exports and production have remained sluggish due to the effects of the slowdown in emerging economies and the yen's appreciation, Japan's economy has continued its moderate recovery trend and the recovery has become more sustainable.
- Japan's economy has continued its moderate recovery trend. However, attention needs to be paid to the fact that a virtuous cycle from income to private consumption has worked only moderately and that polarization among firms has been observed in terms of their fixed investment stance. Looking ahead, the economy is likely to continue growing at a pace above its potential, supported partly by the government's fiscal stimulus.
- As suggested by consumer sentiment indicators that have improved compared to early spring, the actual condition of private consumption is considered not so weak, with negative effects of recent bad weather taken into account.

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.

- Since the propensity to consume cannot continue to decline unlimitedly, its reversal is expected to be the key to strong economic recovery. Moreover, the pace of increase in nominal wages has not been enough to be consistent with the tight labor market conditions. These are the most important points to note in assessing economic and financial developments for the time being.
- Overseas economies are likely to see increases in their growth rates gradually from fiscal 2017 and consequently produce positive effects on Japan's exports, although the downside risks remain.
- Although an appreciation of the yen is considered the most important cause for concern for Japan's economy at present, the yen has reversed to depreciation recently and is expected to shift from the appreciation trend seen so far to a depreciation trend if the Federal Reserve raises its policy rate in December.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is expected to increase toward 2 percent as the output gap improves and medium- to long-term inflation expectations rise. The timing of the CPI inflation rate reaching around 2 percent will likely be around fiscal 2018.
- The momentum toward achieving the price stability target is maintained, but somewhat weak lately. Thus, the timing of achieving the target will likely be delayed to around fiscal 2018.
- Inflation expectations and the output gap have been on rising trends from a somewhat longer-term perspective, and oil prices have shown signs of a reversal. Looking ahead, the inflation rate is expected to increase as the downward pressure on prices gradually dissipates.
- I do not think the inflation rate will reach 2 percent within the projection period, partly because of my cautious outlook on inflation expectations.
- Neither the inflation rate nor inflation expectations are likely to reach around 2 percent in the relatively near future, even beyond the projection period of the latest *Outlook for Economic Activity and Prices* (Outlook Report).

II. Opinions on Monetary Policy

Continuation of Monetary Easing

- An improvement in the output gap brought about by the continuation of the current monetary policy, as well as a reversal of the yen's appreciation trend and a moderate rise in crude oil prices going forward, are expected to raise observed prices and inflation expectations. Since the momentum toward achieving the price stability target of 2 percent thereby is likely to be maintained, it is appropriate that the Bank continue with the current monetary policy.
- As a virtuous cycle in the economy has been in place, the Bank should continue with the current monetary policy so that it can contribute to the long-running battle to overcome deflation.
- Under "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," the inflation rate is expected to increase gradually. For the time being, the Bank should monitor the policy effects under the current framework.

Yield Curve Control

- The attempt to control long-term interest rates under the framework of yield curve control is unprecedented. The framework has been functioning well as the interest rates have been moving within a very limited range.
- As for the amount of Japanese government bonds (JGBs) to be purchased, it is appropriate that the Bank keep the current guideline in which it will purchase JGBs at more or less an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen so that 10-year JGB yields will remain at around zero percent.
- With regard to the approximate amount of JGBs to be purchased -- that is, an annual pace of increase in the amount outstanding of the Bank's JGB holdings of about 80 trillion yen -- the Bank should keep this guideline at this MPM and conduct the purchases in a flexible manner, so as to avoid possible misunderstandings in the market of the Bank's policy intentions.
- Since "QQE with Yield Curve Control" is an unprecedented policy framework for the markets, the Bank should continue to communicate with them and closely monitor the market conditions. Given that considerable uncertainty remains in the market, it is very important for the Bank not to heighten volatilities inadvertently.

- My understanding of the new framework is that the Bank should respond in an asymmetric manner to positive and negative shocks to the economy, in terms of interest rates and quantity. In response to positive shocks -- with which interest rates would rise if the Bank did not change the quantity of the purchases -- the monetary policy effect will be more accommodative if the Bank increases the amount of the purchases so that long-term interest rates remain at 0 percent. On the other hand, in response to negative shocks -- with which interest rates would decline -- the monetary policy effect would be less accommodative if the Bank decreases the amount of the purchases so that long-term interest rates remain at 0 percent. To avoid such a situation, the Bank should maintain the annual pace of JGB purchases of 80 trillion yen, allowing the interest rates to decline below 0 percent.
- As the Bank continues to conduct JGB purchases at around the current pace, the long-term interest rates will decline further through the stock effect of the Bank's increasing holdings of assets. With this in mind, the amount of JGB purchases will need to be adjusted so that the interest rates remain at the target level. Given that the Bank's operating target is set at the interest rates, the Bank should attach declining importance to the approximate amount of JGBs of about 80 trillion yen in the policy statement in due course.
- The stability in financial markets seems to be maintained in spite of increasing speculation that the Bank will gradually reduce the pace of increase in the amount outstanding of its JGB holdings. Under such circumstances, the Bank should set the amount of increase in its JGB holdings as the operating target and reduce it incrementally and steadily, instead of conducting the "yield curve control" under which the controllability of the quantity of the Bank's JGB holdings seems uncertain. These alternative measures will contribute to making the Bank's asset purchases more sustainable and enhancing the stability of the market. By doing so, the Bank can keep long-term real interest rates stably at low levels and thereby secure the accumulated monetary easing effect seen so far, which I believe is most important for the Bank's monetary policy.

Conduct of Monetary Policy Going Forward

- It is appropriate to maintain the current policy stance that the Bank will make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target.

- The Bank's criterion for additional monetary easing is whether it is necessary with a view to maintaining the momentum toward achieving 2 percent, rather than whether the timing of achieving the price stability target will be delayed.
- In the conduct of monetary policy, even though the Bank takes into account the impacts on the financial intermediation function, the Bank's stance that it will make a monetary policy decision based on the impact on Japan's economy as a whole has not changed.
- The Bank should make public the policy reaction function for long-term interest rate control and develop a common understanding through communication with the market and various economic entities.

Others

- The Bank should patiently explain the negative interest rate policy to the general public, since their anxiety over the policy could exert adverse effects on the economy through deterioration in households' confidence.
- The Bank should clearly explain to the public the possible impacts of its monetary policy on its financial conditions.
- In order for long-term interest rate control to work effectively, it is important to maintain the credibility in the JGB market through the government's efforts toward establishing sustainable fiscal structures.
- The Bank needs to closely monitor developments in real estate markets from a macroprudential perspective, although there have been no clear warning signs.

III. Opinions from Government Representatives

Ministry of Finance

- The second supplementary budget for fiscal 2016 was approved by the Diet recently. This aims to realize "investment for the future," and the government will implement this budget in a smooth and appropriate manner, thereby bringing about sustainable economic growth led by private demand.
- At this MPM, there were discussions about revising the economic projections in the Outlook Report. The government expects the Bank to continue to work toward achieving the price

stability target under "QQE with Yield Curve Control," in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- The supplementary budget -- compiled for implementing the Economic Measures for Realizing Investment for the Future -- was approved by the Diet recently. The government also has been working on structural reforms to raise the potential growth rate, including working-style reforms.
- 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, as well as financial conditions.
- The government deems it important that the Bank fully explain to the public its thinking behind the change in the projected timing of achieving the price stability target of 2 percent.