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March 27, 2017

Bank of Japan

## Summary of Opinions at the Monetary Policy Meeting<sup>1,2</sup> on March 15 and 16, 2017

### I. Opinions on Economic and Financial Developments

#### *Economic Developments*

- Japan's economy has continued its moderate recovery trend. Business fixed investment has been on a moderate increasing trend as corporate profits have improved. Private consumption has been resilient against the background of steady improvement in the employment and income situation.
- Japan's economy has continued its moderate recovery trend. Although the pace of its recovery has shown signs of accelerating, domestic consumption and investment are still recovering at a moderate pace.
- Exports and production have remained firm on the back of a global pick-up in manufacturing, mainly supported by IT-related goods.
- Japan's economy is likely to continue to recover in line with the path we expect, backed by synergy effects of the government's large-scale stimulus package and the Bank's monetary easing measures, with improvements in overseas economies.
- Japan's economy is projected to continue to see moderate recovery toward fiscal 2018 unless downside risks stemming from developments in overseas economies materialize, such as a rise of protectionism, political and economic instability in Europe, and an increase in geopolitical risks in the Middle East and Asia.

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<sup>1</sup> English translation prepared by the Bank's staff based on the Japanese original.

<sup>2</sup> "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.

- Overseas economies have been increasingly resilient, but uncertainties in the medium to long run remain as there is a concern about the growing tides of protectionism.
- Amid increasing global uncertainties, investors' risk aversion could increase rapidly, as market participants might not fully factor in the associated risks. On the other hand, if a series of upcoming political events in Europe are cleared, the pricing in the markets could be adjusted to a large extent, reflecting market participants' bullish expectations. In either case, the financial market in Japan will be affected to a certain degree.
- It is a positive development that many firms are expecting to raise their base pay for the fourth consecutive year. As final agreement in the annual spring labor-management wage negotiations is expected to take time, I will carefully monitor the developments in the wage negotiations, including those at small firms.
- Against the background of low growth expectations in Japan in the medium to long run and high uncertainties regarding overseas developments, firms remain cautious in terms of a base pay rise that results in a rise in fixed costs.
- Sluggish wages, a rise in the payment of tax and social security benefits, and a decline in the receipt of pension benefits in real terms collectively have been one of the factors that restrain consumption and delay the achievement of the 2 percent price stability target. These structural issues regarding employment, taxation and public finance, and social security need to be addressed at the earliest possible time.
- As the labor shortages become more intense, it is observed that some firms are urged to change their business model. As the importance of working-style reforms is emphasized publicly, it is worth paying attention to whether those firms will bring about a change in the social norms.

### *Prices*

- The year-on-year rate of change in the consumer price index (CPI) for all items less fresh food is around 0 percent, and is expected to gradually increase toward 2 percent, due in part to the upward pressure on general prices stemming from developments in commodity prices such as crude oil prices. However, it would take some time for the inflation rate to accelerate, as the formation of inflation expectations is adaptive.

- Instead of monitoring superficial price developments, it is necessary to thoroughly examine whether the underlying trend in inflation would rise toward 2 percent, mainly through the improvement in the output gap and the rise in medium- to long-term inflation expectations.
- While developments that underpin the rise in the inflation rate have been increasingly observed, this is now the phase in which to examine how these developments will transmit to the momentum in actual prices.
- In reality, dominant firms with massive fixed costs set their prices in facing competition with other firms. If firms have large fixed costs, it might be reasonable to gain market share by lowering prices. However, this was only the case under deflation in which wages did not rise. When wage increases and price hikes are acknowledged as business strategies and are accepted by the public, this would bring about the overcoming of the deflationary mindset.
- The rate of increase in wages in the annual spring labor-management wage negotiations for the next fiscal year will likely be below that for this fiscal year. I have a more cautious outlook for the underlying trend in inflation compared to the baseline scenario.

## **II. Opinions on Monetary Policy**

- Although the economic recovery in Japan has taken hold more firmly amid improvement in the global economy, there is still a long way to go to achieve the price stability target of 2 percent. Under such circumstances, it is appropriate for the Bank to pursue powerful monetary easing under the current guideline for market operations.
- With the virtuous cycle in the economy working at a moderate pace, we are still only halfway to achieving the price stability target. In order to encourage the virtuous cycle to take hold, the Bank should continue with the current monetary policy.
- To achieve the price stability target, it is important to bring the economy onto a self-sustaining growth path. Given uncertainties regarding overseas economies, the Bank should not rush to action; it should pursue monetary easing under the current framework with patience.
- "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," which includes the inflation-overshooting commitment, is the best possible framework that we can devise at present in order to achieve the price stability target of 2 percent at the earliest possible time.

- The current monetary policy framework has exerted its intended effects, and there have been no obstacles to its operations. There is no need to change the current policy framework in the near future.
- The yield curve of Japanese government bonds (JGBs) has remained in line with the guideline for market operations. This is partly because the Market Operations Desk has been conducting market operations in a flexible manner and announcing a detailed schedule of JGB purchases.
- Some market participants argue that the Bank needs to change the monetary policy in response to the rise in the long-term yields overseas. However, the monetary policy in Japan should be decided based on Japan's economic activity and prices. While the inflation rates in the United States and Europe are coming close to 2 percent, Japan's inflation rate is still around 0 percent. It will be a considerable amount of time before the Bank will need to change its monetary policy.
- As the Bank's monetary policy attracts close attention, what it says could be perceived differently from what it intends, depending on market conditions. Therefore, the Bank should carefully consider market conditions in communicating its policy.
- The fact that the size of JGB purchases increased substantially in February revealed the weakness of yield curve control, in that the Bank could be forced to purchase a large amount of JGBs to achieve the target it sets for the long-term yield.
- I am in dissent with setting the target level of 10-year JGB yields at around 0 percent. The appropriate yield curve for achieving favorable conditions in economic activity and prices should be a little steeper. It is desirable that the Bank should reduce the amount of purchases to the extent possible, partly in preparation for the uncertainties ahead. Meanwhile, taking account of the funding conditions of foreign currencies going forward, upward pressure on the yields of treasury discount bills (T-Bills) could remain moderate in April and onward, thus providing room to further reduce the amount of the Bank's purchases.
- It is expected that upward pressure on long-term yields will strengthen as the underlying trend in inflation improves along with the Bank's forecast as the baseline scenario. It is necessary to start discussing the procedures for yield curve control in that situation and the Bank's policy reaction function.

- Under yield curve control, while it is difficult for the Bank to control the interest rates in the markets and market expectations, there is a risk of losing flexibility in adjusting the amount of JGB purchases as the JGB purchase operation is influenced by the market expectations. Therefore, the Bank should instead set the amount of increase in its assets as the operating target and reduce the amount incrementally in a gradual and orderly manner so that the sustainability of its policy and the stability of financial markets will be enhanced.

### **III. Opinions from Government Representatives**

#### ***Ministry of Finance***

- It was reaffirmed in the joint statement of the Japan-U.S. Summit Meeting that the three-pronged approach of fiscal, monetary, and structural policies should be taken in conducting economic measures.
- It was agreed that Deputy Prime Minister Aso and Vice President Pence will launch a new framework for economic dialogue between Japan and the United States, through which economic policies and other matters will be discussed.
- 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***

- Labor and management agreed recently on the direction of the amendment of the relevant laws for correcting the practice of working long hours.
- Although the annual spring labor-management wage negotiations are still in their initial stage, a considerable number of firms are conducting base pay increases for the fourth consecutive year, and some firms' wage increases are exceeding the previous year's level. Thus, the government deems that the trend of wage increases in the past three years has been continuing. In addition, there are firms working on 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.