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July 28, 2017

Bank of Japan

## Summary of Opinions at the Monetary Policy Meeting<sup>1,2</sup> on July 19 and 20, 2017

### I. Opinions on Economic and Financial Developments

#### *Economic Developments*

- A virtuous cycle from income to spending has been operating in both the corporate and household sectors in Japan, and a positive output gap has taken hold. Based on such circumstances, it is appropriate for the Bank to revise upward its economic assessment to one stating that Japan's economy "is expanding moderately."
- Japan's economy is expanding moderately. Private consumption has increased its resilience, and the economy is likely to continue growing at a pace above its potential in fiscal 2017 and 2018. Thereafter, in fiscal 2019, the growth pace is projected to decelerate due in part to the effects of the scheduled consumption tax hike.
- Improvements in economic activity have been spreading, from external demand to domestic demand and from urban areas to regional areas. Under such circumstances, Japan's economy is shifting toward a more self-sustaining growth phase and is increasing its resilience to exogenous shocks.
- The extent to which labor shortage constrains economic growth warrants careful attention going forward. Although labor shortage would constrain corporate activities somewhat temporarily, firms' efforts to overcome the issue are likely to lead to creativity and innovation in the medium to long run.

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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.

- Firms that face labor shortage are taking measures such as labor-saving investment and a streamlining of their business process. A rise in labor productivity through such measures could lead to a higher potential growth rate from a somewhat longer-term perspective.

### *Prices*

- The year-on-year rate of change in the consumer price index (CPI) is likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations. The timing of the year-on-year rate of change in the CPI reaching around 2 percent will likely be around fiscal 2019.
- Medium- to long-term inflation expectations are expected to rise through the adaptive formation mechanism of expectations, if the output gap improves steadily and the observed inflation rate increases on the back of firms' stance shifting toward raising wages and prices.
- Prices will rise in line with the past experience, with the unemployment rate declining further and the output gap widening further within positive territory, if the Bank continues with the current monetary policy. Since there is a time lag of about half a year between the output gap and prices, prices will rise even in the case where the output gap does not change within positive territory. It also can be pointed out that there is a mechanism in which a rise in actual prices leads to an increase in inflation expectations, resulting in a further rise in actual prices.
- The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase gradually toward 2 percent. However, it is anticipated that it will take longer than expected to reach 2 percent, as developments such as in commodity prices and inflation expectations have not been sufficiently firm while the output gap has been positive.
- The main cause of relatively weak developments in prices is that sluggish recovery in consumption after the consumption tax hike in 2014 has made it difficult for firms to raise prices even when labor costs have increased due to the labor shortage. In order to achieve the price stability target of 2 percent, it is necessary to improve the output gap through an expansion of consumption and make firms' price-setting stance bullish.
- In Japan, it seems that it has been taking time for prices to rise because households and firms have been adaptive to the deflationary environment. However, the conditions of a change in the social norm are being put in place.

- Firms' efforts to absorb the upward pressure on wages could push down prices in the short run, but an increasing labor shortage is expected to start exerting upward pressure on wages sooner or later.
- Room for a further increase in labor productivity in the services sector remains large, and there is some way to go before the tightening of labor markets leads to rises in wages and prices.
- The reason why firms prioritize cost reductions and thereby avoid raising prices is because growth expectations are low. Thus, it is important to implement structural policies that would raise growth expectations, together with monetary policy.
- My outlook is that the inflation rate will remain considerably below 2 percent during the projection period through fiscal 2019, and that even thereafter achieving 2 percent would not be in sight.

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

- The momentum toward achieving the price stability target of 2 percent is maintained. However, as it is not yet sufficiently firm, it is important for the Bank to pursue the current powerful monetary easing with persistence, while taking account of developments in economic activity and prices as well as financial conditions.
- Although the recent price developments have been sluggish, the improving trend in economic activity has strengthened and the momentum toward achieving the price stability target is maintained. Therefore, it is important to maintain the current monetary policy framework and carefully monitor its effects.
- Although the CPI projections have been lowered, the momentum toward achieving 2 percent is firmly maintained at this point. Thus, additional monetary easing is not necessary and the Bank should maintain the current policy.
- The Bank should continue with the current monetary policy with the aim of persistently encouraging the virtuous cycle to take hold and completely overcoming deflation.
- Although it takes some time, the mechanism of improving the output gap steadily and expanding consumption is incorporated under "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control." The Bank should continue with the current monetary policy until the price stability target of 2 percent is achieved sustainably.

- It is expected that people's views on economic growth and prices will change going forward as the economy continues expanding moderately and the observed inflation rate rises. Under such circumstances, the effects of the current accommodative monetary policy to maintain the short- and long-term interest rates are likely to strengthen further.
- Real GDP has been growing at an annual pace of more than 1 percent. Since the estimated potential growth rate is likely to be more than 1 percent going forward as well, the economic stimulus effects of monetary policy will strengthen if the 10-year Japanese government bond (JGB) yields are to be fixed at around 0 percent. If prices rise under such circumstances, the monetary policy effects should strengthen further.
- In addition to measures taken by the government and the private sector with a view to reinforcing the competitiveness and growth potential, it is important for the Bank to pursue its powerful monetary easing with persistence. In doing so, it remains crucial for the government and the Bank to be closely aligned with each other.
- I am of the view that the Bank's policy of achieving the price stability target of 2 percent at the earliest possible time is a constraint on the flexibility of monetary policy and makes it difficult to normalize monetary policy going forward. The Bank should clearly change this target to a medium- to long-term one.
- The repeated postponement of the timing of achieving the price stability target could undermine the credibility of the Bank's outlook for prices. While maintaining the stance of achieving the target at the earliest possible time, it is appropriate for the Bank to change the target to a medium- to long-term and flexible one, given that price stability is a comprehensive concept that includes economic and financial stability.
- In order to achieve both of the Bank's two mandates -- that is, price stability and financial system stability -- the Bank should place more weight on the latter in implementing monetary policy. Reverting the interest rate applied to financial institutions' excess reserves to 0.1 percent and abolishing yield curve control could contribute to this aim.
- The range of the target level of 10-year JGB yields of "around zero percent" should not be interpreted too strictly.
- It is appropriate to set the new target of JGB purchases at an annual pace of increase of about 45 trillion yen, and then to reduce the pace of purchases in an orderly and incremental manner.

- It is desirable that an in-depth discussion about the appropriateness of continuing exchange-traded fund (ETF) purchases of about 6 trillion yen annually will take place going forward.

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

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

- At the Group of Twenty (G-20) meeting held recently, it was agreed to use all policy tools -- monetary, fiscal, and structural -- individually and collectively.
- At the Council on Economic and Fiscal Policy held recently, the government decided the fiscal 2018 budget overview. It plans to decide the guidelines for budget requests for fiscal 2018 also in view of the prime minister's instructions.
- 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***

- Sustainable economic growth is essential to fiscal soundness. The government will focus on working-style reforms, and proceed with budget formulation so as to ensure priority-based budgeting that allocates funds to measures such as investments in human resources and productivity improvements.
- The government expects that the Bank will work steadily 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.