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May 10, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]
on April 26 and 27, 2018

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Going forward, it is likely to continue expanding, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending.

- Japan's economy is expanding moderately. In fiscal 2018, the economy is likely to continue growing at a pace above its potential. From fiscal 2019 onward, the growth pace is projected to decelerate temporarily, due mainly to the effects of the scheduled consumption tax hike, and recover gradually thereafter.

- Japan's economy has been growing steadily with the balance between supply and demand being maintained. With increased supply-side constraints being observed in part, the negative hysteresis that arose in the past -- such as firms' inefficient business processes -- has been dissipating, and firms have been working on increasing their production capacity.

- Overseas economies will likely continue growing firmly amid trade volumes showing solid growth in both advanced and emerging economies.

- Real interest rates have been declining, with some indicators showing a rise in short-term inflation expectations and nominal interest rates being stable at low levels. Investment has

[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.

been active, partly reflecting the decline in real interest rates. Moreover, it also is possible that long-term growth rates are rising, and business fixed investment is increasing accordingly.

- Regarding the scheduled consumption tax hike, the burden on households is expected to be smaller than that of the last consumption tax hike. However, attention needs to be paid to the effects of the tax hike on consumer sentiment and inflation expectations, since these effects cannot be ignored, as shown in the Bank's Comprehensive Assessment.

- Developments in U.S. financial conditions warrant vigilance. If the financial conditions were to tighten, triggered by certain events, this could affect mainly emerging economies and give rise to changes in global financial markets.

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.

- A base pay increase is likely to take place for five consecutive years in the annual spring labor-management wage negotiations, with the rate of increase exceeding that of last year. A rise in prices of raw materials also has been observed. Moves to pass on the increased costs to prices have been spreading, as evidenced by the diffusion index (DI) for output prices for small enterprises in the March 2018 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) having turned positive for the first time in 27 years.

- On the wage side, whether real wages will increase is of importance. Changes in the mindset of both labor and management as well as firms' efforts toward raising labor productivity warrant close attention.

- Expansion in the economy's supply capacity, in the short run, reduces upward pressure on wages and prices; in the long run, however, it could raise the economy's growth potential and contribute to pushing up wages and prices, mainly through an increase in permanent income.

- Achieving the price stability target requires not only a rise in inflation on the back of an improvement in the output gap but also a rise in medium- to long-term inflation expectations to a level close to those in other advanced economies.

- The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase moderately toward 2 percent. It seems to take some time to reach 2 percent, however, as the inflation expectation formation is adaptive.

- Although the tightening supply-demand conditions in capital stock and the labor market have led to firms' positive stance to some extent, their stance shifting toward raising prices is not strong enough to push up inflation to 2 percent.

II. Opinions on Monetary Policy

- Considering that there is still a long way to go to achieve the price stability target of 2 percent, it is appropriate to pursue powerful monetary easing with persistence under the current guideline for market operations in order to firmly maintain the momentum toward achieving the price stability target.

- The Bank should continue with the current monetary policy with the aim of persistently encouraging the virtuous cycle to take hold and achieving the price stability target. At the same time, the Bank should make efforts to create a situation where its intention with the price stability target is widely shared among the public.

- In order to continue with powerful monetary easing, the Bank needs to constantly consider enhancing its sustainability while aiming to gain consensus among the public on the necessity of the price stability target.

- The effects of monetary easing measures will be enhanced in a situation where inflation and the economy's growth potential rise. It will be necessary to consider appropriate policy conduct without preconception while taking into account its effects on the supply-demand balance and the financial system.

- Looking at recent developments in corporate bond markets and bank lending, monetary easing effects -- stemming from the decline in the long-term real interest rates -- on economic activity and prices could be becoming smaller. It is important to make further consideration concerning the desirable shape of the yield curve, given the cumulative impact on financial institutions' financial strength becoming increasingly severe.

- Market participants are sometimes said to be anticipating an early interest rate hike. However, if interest rates are actually raised, bond and stock prices will fall, credit costs will increase amid firms' profitability deteriorating due to the yen's appreciation, and this will deliver a big blow to financial institutions. Moreover, even if short-term interest rates are raised, long-term interest rates will not necessarily rise, and the spread between long- and short-term interest rates might narrow. This actually had occurred in Japan from 2006.

- The purchases of risky assets including exchange-traded funds (ETFs) are carried out as part of the policy package aiming at achieving the price stability target, and their policy effects and the possible side effects should continue to be examined from every angle.

- From the perspective of enhancing the effectiveness of monetary policy as the Bank persistently continues with the current monetary easing, it is necessary to make efforts to give a clear explanation on the meaning of "exit" and "normalization," and gain understanding among the public that the Bank can respond flexibly depending on developments in economic activity and prices as well as financial conditions.

- The timing of reaching around 2 percent inflation in the *Outlook for Economic Activity and Prices* (Outlook Report) is merely a projection, and thus changes in such timing and policy adjustments are not mechanically linked. It also is appropriate to make this clear from the perspective of communication with the markets.

- It is necessary to clearly communicate that the Bank's commitment to achieving the price stability target of 2 percent at the earliest possible time has not changed at all, even when the description on the projected timing of reaching around 2 percent inflation has been reviewed.

- There is concern that, if the description on the timing of reaching around 2 percent inflation is reviewed, the Bank's commitment toward achieving the price stability target could be weakened. It is necessary to encourage a widening of the output gap within positive territory and a rise in inflation expectations by clearly stating the timing of achieving the price stability target, taking additional easing measures, and reinforcing the commitment.

- The significance of the joint statement of the government and the Bank on overcoming deflation and achieving sustainable economic growth should be reconfirmed at the start of the new term of the Governor and Deputy Governors of the Bank. Externally, it also is necessary to continue to strengthen communication going forward for the purpose of widely spreading the understanding of the price stability target of 2 percent. The key to the current policy lies in the Bank's commitment. It is desirable to continue further research and discussions as to whether there are any measures to strengthen the commitment.

- In the case where risk factors to achieving the price stability target are likely to materialize, it might be appropriate for the government and the Bank to cooperate in light of the principle of the joint statement and to consider taking specific actions.

III. Opinions from Government Representatives

Ministry of Finance

- The government and the Bank recently reconfirmed that they will commit to the joint statement. The government will continue to carry out all possible measures while working closely with the Bank, and aim at overcoming deflation and realizing strong economic growth.

- The budget for fiscal 2018 was approved by the Diet on March 28. The government will work to swiftly and steadily implement the budget.

- The government expects the Bank to continue to work toward achieving the price stability target under "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- The government will thoroughly fulfill its role specified in the joint statement, the commitment to which was reconfirmed recently.

- The government deems it appropriate to review the description on the timing of achieving the price stability target in the Outlook Report. It expects the Bank to fully explain its thinking to the public.

- The government expects the Bank to steadily pursue monetary easing toward achieving the price stability target as specified in the joint statement, in light of developments in economic activity and prices, as well as financial conditions.