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November 8, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]
on October 30 and 31, 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.

- As for external demand, although projections for the global economic growth rate by the International Monetary Fund (IMF) were revised downward slightly, it is expected to remain relatively high for the time being, in the range of 3.5-4.0 percent. Positive momentum in domestic demand has been maintained and the September *Tankan* (Short-Term Economic Survey of Enterprises in Japan) reconfirmed enterprises' strong fixed investment stance.

- The effects of natural disasters on Japan's economy are likely to be only temporary, partly reflecting successful results of the government's and the private sector's efforts that take advantage of valuable lessons learned in the past.

- 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, due mainly to the effects of the scheduled consumption tax hike. It is necessary to pay attention to downside risks to overseas economies.

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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.

- Although Japan's economy has continued its moderate expansion, the momentum toward economic expansion recently has weakened somewhat due to such effects as of natural disasters and trade conflicts between the United States and China. It is necessary to pay due attention to heightening uncertainties regarding overseas economies.

- Against the background of trade friction and a rise in U.S. interest rates, the global economy is beginning to level off. Uncertainties regarding such developments as protectionist moves and negotiations on the United Kingdom's exit from the European Union (EU) have heightened since the previous meeting.

- Some argue that the recent fall in stock prices reflects projections for possible losses resulting from the trade friction between the United States and China, but its effects are not clear yet. However, when looking at stock prices in Japan by industry, the fall is large for external demand-oriented firms and small for domestic demand-oriented firms. Thus, the fall in stock prices certainly seems to reflect the effects of the trade friction to some extent.

- Although stock prices have seen large fluctuations on a global basis, economic fundamentals both at home and abroad have been favorable.

- In assessing the effects on Japan's economy of the trade friction between the United States and China, we should pay attention so as not to be inclined toward extremely pessimistic views.

- In the United States, since covenant-lite loans -- that is, loans with eased financial covenants -- and the delinquency rates of subprime auto loans have increased, their future developments warrant close attention.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising.

- The basic mechanism for a rise in inflation has been operating firmly, as seen, for example, in the year-on-year rate of change in the CPI having picked up gradually, after hitting bottom in the April-June quarter, and the diffusion index (DI) for output prices in the *Tankan* having remained within positive territory.

- The year-on-year rate of increase in the CPI (less fresh food) is likely to continue accelerating moderately. Nevertheless, as such developments have been weak and unstable, it is projected that achieving 2 percent inflation will take some time.

- Although the main scenario is that actual prices will rise with the output gap widening within positive territory and that inflation expectations also will rise through the adaptive formation mechanism, downside risks have been heightening in overseas economies that are at the basis of this scenario.

- A rise in inflation has been delayed with a positive output gap. This is attributable to the inflation mechanism becoming complex, as seen, for example, in improvement in productivity on the supply side constraining the rise in inflation, as well as to heightening uncertainties going forward.

II. Opinions on Monetary Policy

- Although it will take time to achieve the price stability target, it is necessary to persistently continue with the current powerful monetary easing as the momentum toward 2 percent inflation is maintained.

- The Bank should continue with the current monetary policy stance with the aim of persistently encouraging the virtuous cycle to take hold and achieving the price stability target.

- As the underlying trend in prices has continued to show relatively weak developments compared to the economic expansion and the labor market tightening, it is necessary to persistently maintain highly accommodative financial conditions.

- It is important to patiently wait for a rise in inflation by continuing with the current monetary easing policy that aims at maintaining the positive output gap, while carefully examining possible side effects on the financial system.

- Since the policy decision in July, Japanese government bond (JGB) yields have moved to some extent depending on developments in economic activity and prices. This can be assessed as movements within the range in which the effects of powerful monetary easing are ensured.

- The current situation where the inflation rate does not seem to be accelerating toward 2 percent should be taken seriously. In this situation, making the range of movement in the long-term yields more flexible, a move that is raised by some market participants, could be viewed as if the commitment to achieving 2 percent inflation was compromised.

- Attention should be paid to whether the positive effects on inflation expectations will diminish instead if the target level of the long-term yields is maintained at around zero percent for a long time. It is important to consider in a flexible manner such factors as the range of yield movement and the target maturity of JGBs in conducting yield curve control, while maintaining the framework of monetary easing.

- Monetary policy cannot solve the structural problem that borrowing needs are not sufficient compared to the size of the financial industry. What can be accomplished through monetary policy is to lower the adjustment cost in the economy by (1) avoiding deflation through sufficient monetary easing at an early stage, (2) expanding nominal GDP, and (3) increasing nominal production of all industries including the financial industry.

- Since regional financial institutions have increased relatively high-risk loans such as those to middle-risk firms amid the decreasing trend of lending rates, there is a risk that their profits would worsen at an accelerated pace if the economy moves into a downturn and their credit costs materialize. These points warrant careful attention.

- With regard to the examination of risks concerning the financial system, it is necessary to pay attention to various factors such as structural changes that cannot necessarily be described by economic models.

- As a policy tool for addressing the problem of a decline in the functioning of financial intermediation, the importance of prudential policy should not be overlooked, although some hold a view that focuses on such monetary policy factors as changing the target levels of interest rates.

- With high uncertainties in the economy, such as regarding the scheduled consumption tax hike, there is a low possibility that the output gap will continue to widen within positive territory. There is also a possibility that the degree of transmission from the output gap to prices has weakened. In this situation, it is likely to take longer than expected for the transmission channel of inflation through the adaptive formation mechanism to fully start working. Therefore, it is more important to influence inflation expectations directly toward achieving the price stability target at the earliest possible time. Further enhancement of policy coordination with the government, coupled with the strengthening of monetary easing, seems to be needed.

- There are views that monetary policy cannot resolve challenges for Japan's economy such as fiscal sustainability and a decline in the potential growth rate. Since the introduction of quantitative and qualitative monetary easing (QQE), however, employment and fiscal conditions have improved and the potential growth rate has been stable.

III. Opinions from Government Representatives

Ministry of Finance

- The government recently submitted the supplementary budget for fiscal 2018 to the extraordinary Diet session in order to implement measures such as for the restoration and reconstruction of areas affected by a series of natural disasters.

- The government is planning to raise the consumption tax rate from 8 percent to 10 percent in October 2019, mainly with a view to securing stable financial resources for countermeasures against the declining birthrate and social security. It will take all possible measures so that the scheduled consumption tax hike will not affect the economy.

- The government expects the Bank to continue to work toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions.

Cabinet Office

- Regarding reforms toward the creation of social security for people across all generations as well as realization of the fourth industrial revolution, the government will compile an interim report by the end of the year and decide the action plan by next summer, including the three-year work schedule.

- Making use of the experience of the previous consumption tax hike, the government will do its utmost to carry out all possible measures so that the scheduled consumption tax hike in 2019 will not affect the economy.

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