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December 28, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on December 19 and 20, 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.
- The effects of trade friction and the global decline in stock prices on Japan's economy have been limited so far, and the baseline scenario that the economy will continue its moderate expansion is maintained.
- Although the second preliminary estimate of real GDP for the July-September quarter registered negative growth, which was below market expectations, this is basically likely to be mainly due to the effects of temporary factors such as natural disasters.
- Although Japan's GDP for the July-September quarter registered negative growth, the basic mechanism for moderate economic expansion is maintained, as confirmed, for example, by the *Tankan* (Short-Term Economic Survey of Enterprises in Japan) showing that there has been no change in the increasing trend in business fixed investment. On the other hand, downside risks to the outlook have been heightening amid growing uncertainties in the global economy, including the trade friction between the United States and China.

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.

- Japan's economy is expanding moderately. While tight supply-demand conditions have been encouraging expansion of production capacity, it is necessary to pay attention to increasing downside risks to overseas economies.
- As the restoration of infrastructure has progressed following the successive natural disasters, production and exports have picked up after declining. However, we cannot be optimistic regarding the outlook for economic activity since cautious views have been increasing against the background of the trade friction between the United States and China.
- While moves to increase investment and wages have started to be seen in the corporate sector, a challenge lies in the household sector in that the mechanism of the virtuous cycle from income to consumption expenditure has been operating weakly. Attention should be paid to this point in considering the effects of the scheduled consumption tax hike on economic activity and prices.
- As for overseas economies, positive momentum in domestic demand has been maintained in many economies. With regard to the outlook, overseas economies are expected to continue growing firmly on the whole.
- Although we are no longer in an ideal situation of so-called synchronous growth of the global economy, the virtuous cycle in the economy has been maintained, as seen, for example, in domestic demand continuing to be firm in many economies.
- Overseas economies have started to show signs of decelerating, with differences among regions becoming clearer. If the deceleration and downturn in these economies become evident, developments in fiscal and monetary policies in each economy will be important.
- Regarding the outlook for the global economy, risks have been tilted to the downside on the whole amid heightening uncertainties and a prevailing view that such situation will be protracted.
- Downside risks to economic activity have been heightening. Looking at the latest data on trade activities in China, both exports and imports marked negative growth on a month-on-month basis, which possibly indicates a deceleration in the Chinese economy. Turning to Japan's economy, it cannot be said that the actual condition of restoration-related demand and production stemming from natural disasters has been strong. In addition, the recovery in exports to China has been weak, and exports as a whole also have shown weak developments.

- In China, defaults of private firms have been increasing, and authorities have been requesting that banks increase lending in order to resolve the difficulty in funding. Developments in private firms' funding under these circumstances 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 in which a positive output gap is a driver for moderate inflation has been operating, as seen, for example, in the diffusion index (DI) for output prices in the *Tankan* having remained within positive territory not only for large but also small enterprises, with tight labor market conditions continuing.
- A positive output gap has exerted upward pressure on prices and the year-on-year rate of change in the CPI has been positive. However, the impact of a decline in crude oil prices on inflation will be a matter of concern going forward.
- While upward pressure on inflation resulting from a positive output gap and the constraining effects on inflation accompanying factors such as a rise in productivity have affected each other in a complex manner, a rise in inflation has been delayed and uncertainties regarding the outlook have been heightening.
- In the July *Outlook for Economic Activity and Prices* (Outlook Report), it was mentioned that "many of the factors that have been delaying inflation are likely to be resolved gradually." Looking at subsequent developments, however, it is likely to still take more time for these factors to be resolved.
- There is a low possibility that the output gap will continue to widen within positive territory going forward, and a decline in crude oil prices also will contribute to further delaying the achievement of the price stability target.

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.
- In a situation where there are high uncertainties regarding economic and price developments, it is important to sustain moderate economic expansion while avoiding an accumulation of imbalances, and essential to continue with the current monetary easing while carefully examining the positive effects and side effects of the policy.
- Trying to normalize monetary policy prematurely before achieving the price stability target could adversely strengthen the side effects. Since the impact of these effects is cumulative, it is necessary to achieve the price stability target at the earliest possible time by conducting additional monetary easing and strengthening the commitment.
- At the July MPM, it was decided to conduct market operations as well as asset purchases in a more flexible manner. So far, this generally has been producing its intended results.
- In accordance with the strengthening of the framework for continuous powerful monetary easing in July, the long-term yields should be allowed to temporarily turn negative. It is natural for such yields to move upward and downward more or less symmetrically from around zero percent. It would be desirable to increase or decrease the amount of Japanese government bond (JGB) purchases in a flexible manner while bearing in mind the approximate amount 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.
- Although the long-term yields rose after the Bank made policy adjustments that allowed them to move more significantly, they have been declining recently. This is likely to be due to concerns regarding the outlook for the global economy resulting from factors such as the trade friction between the United States and China. Under these circumstances, if the Bank conducts market operations that would bring back interest rates to their previous levels, this instead will tighten monetary conditions more than at present.
- There is likely room for the current conduct of JGB purchase operation to be revised to some extent, taking into consideration (1) the large stock effect of reducing term premiums reflecting the cumulative amount of JGBs through purchasing long-term JGBs and (2) the low remaining ratio of newly issued bonds in the JGB market.

- It is reported that the ratio of deals with unsold bonds in the corporate bond market has been increasing due to the current low interest rate environment. There is a possibility that investors' demand for corporate bonds will increase in case of higher longer-term interest rates. In this context, it could be regarded as a future option to consider in a flexible manner factors such as the range of yield movement and the target maturity of JGBs.
- It will be more difficult to overcome deflation completely if the directions of fiscal and monetary policies are different. Further coordination between the two policies is important.
- It is expected that the underlying trend in prices will be very difficult to grasp next fiscal year due to various special factors such as the effects of the scheduled consumption tax hike and provision of free education, as well as a possible decline in crude oil prices and a reduction in mobile phone-related prices. Therefore, in conducting monetary policy, it is important to keep in mind more sufficient and courteous communication.

III. Opinions from Government Representatives

Ministry of Finance

- The government is in the process of finalizing the budget for fiscal 2019 amid expenditure reforms based on the New Plan to Advance Economic and Fiscal Revitalization as well as the stance of taking emergency and special measures to smooth out the economic impacts caused by the scheduled consumption tax hike. In addition, it is formulating the second supplementary budget for fiscal 2018.
- As for tax reform in fiscal 2019, the government will prepare draft tax codes reflecting the ruling parties' outline.
- 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

- In the government's economic outlook -- approved by the Cabinet on December 18 -- the real GDP growth rates for fiscal 2018 and 2019 are projected to be about 0.9 percent and about 1.3 percent, respectively.

- The Basic Principles of Fiscal 2019 Budget Formulation was decided by the Cabinet on December 7. At the Council on Economic and Fiscal Policy today, the 2018 reform time schedule will be formulated and the countermeasures for the scheduled consumption tax hike will be reported by Minister Motegi.
- 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.