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January 26, 2022

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on January 17 and 18, 2022

I. Opinions on Economic and Financial Developments

Economic Developments

- A pick-up in Japan's economy has become evident. The economy is likely to recover as downward pressure stemming from the novel coronavirus (COVID-19) on services consumption and the effects of supply-side constraints wane, while being supported by an increase in external demand, accommodative financial conditions, and the government's economic measures.
- Japan's economy is likely to continue recovering moderately. In fiscal 2022, it is highly likely to grow at a pace that is well above its potential growth rate, partly supported by the government's economic measures.
- Amid the spread of the Omicron variant, it is necessary to closely monitor how efforts will be made to sustain the resumption of economic activity while protecting public health, as well as how consumer sentiment will change under the circumstances.
- As more areas will likely be under priority measures to prevent the spread of disease, it is inevitable that moves to voluntarily limit economic activities will spread among the public to some extent. Thus, there could be somewhat of a delay in the timing at which real GDP will return to the pre-pandemic level.
- Along with the spread of the Omicron variant, there have been heightening uncertainties regarding the outlook for Japan's economy.

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 a pick-up in Japan's economy has become evident, attention needs to be paid to the risk that the spread of COVID-19 in China and the accompanying public health measures taken there will have a negative impact on Japan's economy through downward pressure on external demand and amplification of supply-side constraints.

Prices

- The year-on-year rate of change in the consumer price index (CPI), despite being affected by a reduction in mobile phone charges, has been slightly positive, reflecting price rises of energy and other items. Meanwhile, inflation expectations have risen moderately.
- The year-on-year rate of change in the CPI is likely to increase gradually, albeit with fluctuations, with the output gap improving and cost increases being passed on to consumer prices.
- The year-on-year rate of change in the CPI is expected to exceed 1 percent on the back of an increase in inflationary pressure stemming from both a rise in energy prices and many firms changing their price-setting behavior while taking into account the limitation of business models adopted during past deflationary periods.
- Although changes have been observed in firms' price-setting behavior and inflation expectations, achieving the price stability target by the end of fiscal 2023 is difficult given developments in the output gap and inflation expectations.
- Risks to prices are generally balanced. Regarding firms' price-setting stance, there is a downside risk that firms will absorb cost increases by reducing their margins due to concern over a decline in sales if they raise selling prices. On the other hand, there is an upside risk that firms will accelerate the pass-through of cost increases to selling prices if they consider a recovery in private consumption to be robust against rises in selling prices.
- From April 2022 onward, the year-on-year rate of change in the CPI may momentarily rise to a level close to 2 percent if the effects of the reduction in mobile phone charges dissipate and other factors simultaneously contribute to pushing up the CPI. In such a case, it will become important to analyze what lies behind this inflation and whether it turns out to be sustainable.
- There is a possibility that the year-on-year rate of change in the CPI will reach around 1.5 percent temporarily in the first half of 2022. That said, whether the rate thereafter will come close to the price stability target of 2 percent and stay at that level with the inflation

momentum being maintained depends on the strength in demand, suggested by developments in wage inflation and medium- to long-term inflation expectations.

- It is important to carefully examine the underlying trend in prices from the viewpoint of whether inflation from the next fiscal year onward will spread to services as well, of which prices are considered to be rigid, and whether it will be sustainable in the sense that it is accompanied by increases in wages and income.
- The key factor in assessing the underlying trend in the CPI is developments in wages. In order for the CPI to increase as a trend, it is necessary that services prices rise along with wage increases.
- The rate of increase in the producer price index (PPI) has remained high, and the increase is expected to be passed on to the CPI, at least to some extent. Given this possible pass-through and various measures taken by the government to encourage wage increases, attention is paid to whether people's medium- to long-term inflation expectations will rise through the adaptive formation mechanism and their tolerance of price rises will improve.
- It is necessary to closely monitor changes in the extent of the pass-through of raw material cost increases and developments in wages and employment, which affect households' tolerance of price rises.
- The current situation of prices should be assessed based on a wide range of indicators, such as those capturing the underlying trend in the CPI, the GDP deflator, and those showing developments in employment and income.
- Wages are less likely to rise in Japan compared with Europe and the United States. However, if the output gap improves and the pass-through of cost increases becomes feasible, wage inflation is expected to increase with the government encouraging firms to raise wages.

II. Opinions on Monetary Policy

- The rapid spread of the Omicron variant has heightened uncertainties over the outlook for economic activity and prices. In this situation, the Bank should continue to do its utmost to support financing, mainly of firms, and maintain stability in financial markets for the time being. Therefore, it is appropriate for the Bank to maintain the current monetary easing.
- For the time being, the Bank should closely monitor the impact of COVID-19 and not hesitate to take additional easing measures if necessary. It is appropriate for the Bank to

maintain the current inflation-overshooting commitment and forward guidance for the policy rates.

- Financial conditions have been accommodative on the whole, although weakness in firms' financial positions has remained in some segments.
- Given, for example, that part of economic activity is still affected by COVID-19, it is necessary to examine the impact of the partial extension decided at the previous MPM of the Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19).
- In order to achieve the price stability target of 2 percent, firms' and households' mindset regarding prices needs to change, and it is therefore important for the Bank to persistently continue with the current monetary policy.
- Medium- to long-term inflation expectations in Japan have not been anchored, in the sense that they react to economic shocks. The most certain way to anchor them with a view to achieving the price stability target is to continue with monetary easing until it is confirmed that observed CPI inflation of 2 percent has taken hold.
- In the conduct of monetary policy, the Bank should strengthen its monetary easing stance with a view to improving the output gap and inflation expectations, and thereby achieve an economic recovery and the price stability target early.
- Since it will still take time to achieve the price stability target of 2 percent in a stable manner, there has been no change in the Bank's basic thinking that it should continue with the current powerful monetary easing. It is important for the Bank to firmly maintain its policy stance and clearly communicate it to the public.
- The Bank will continue with monetary easing until the price stability target is achieved in a stable and sustainable manner. It should communicate this policy intention to the public well to avoid misunderstanding.
- The Bank will continue with monetary easing until CPI inflation meets the 2 percent price stability target in a stable and sustainable manner. The Bank needs to clearly explain this stance to the public, together with its thinking on desirable inflation vis-à-vis developments in Japan's economy.
- Sustainable economic growth, accompanied by an expansion in the flow of funds through a continued increase in firms' investment in tangible and intangible assets, is necessary to

achieve the price stability target. In order to realize such growth, dynamism of the labor force and firms as well as investment in human capital should be encouraged.

- Loan disbursement made under the Climate Response Financing Operations in December last year suggests that investment to address climate change, including that by small and medium-sized firms, may be undertaken at a larger-than-expected scale. The Bank therefore should gather information and make an analysis of firms' initiatives and investment plans.

III. Opinions from Government Representatives

Ministry of Finance

- On January 17, the government submitted to the Diet the budget for fiscal 2022. With this budget, the government will realize a new form of capitalism through a virtuous cycle of growth and distribution while taking all possible measures to contain the spread of COVID-19. The budget aims at putting priority on certain areas based on the guiding principles in the budget formulation that are outlined in the Basic Policy on Economic and Fiscal Management and Reform 2021.
- The government will work to obtain approval from the Diet for the budget at the earliest possible time so that it can do its utmost with regard to containing the spread of COVID-19 as well as economic and fiscal management.
- The government expects the Bank to conduct necessary measures appropriately, including responses to COVID-19, while cooperating with the government.

Cabinet Office

- The government will further strengthen the series of steps of prevention, testing, and early treatment of COVID-19 and accelerate administration of the third dose of the vaccine in order to create an environment where socioeconomic activities can continue as much as possible, and thereby ensure safety and security.
- The government will swiftly and steadily implement its economic measures to prevent further deterioration in the economy, realize a virtuous cycle of growth and distribution, and in turn put the economy on a self-sustained growth path.
- The government expects the Bank to continue to conduct appropriate monetary policy while carefully monitoring, for example, the impact of COVID-19 on the economy.