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December 28, 2017

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]

on December 20 and 21, 2017

I. Opinions on Economic and Financial Developments

Economic Developments

- With regard to overseas economies, production and trade activities in the manufacturing sector have become active globally, with domestic demand being firm in many economies.

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

- Japan's economy has been growing in a well-balanced manner. In addition to cyclical factors, an increase in its medium- to long-term growth potential through the rises in productivity and the labor force participation rate has been supporting recent positive economic growth, which has continued for seven consecutive quarters.

- Japan's economy is expanding moderately. Business sentiment has been improving with labor shortages prevailing nationwide, albeit to varying degrees among regions. Going forward, a virtuous cycle in the economy is likely to remain in place firmly.

- In 2018, private consumption is likely to be firm as the rate of wage growth is expected to be higher than in 2017, in light of labor shortages and high levels of corporate profits.

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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 can be judged as growing in a relatively well-balanced manner, it is important for private consumption to become a driving force of the economic growth going forward.

- An outlook that the burden to be borne by people in the future is likely to increase in various ways, including through the consumption tax hike scheduled in 2019, has restrained households' spending.

- In a recent Cabinet decision, the government laid out measures such as tax cuts for firms that raised wages proactively. I will follow developments with the expectation that these initiatives will lead to a breakthrough for the current situation where firms are hesitant to raise wages.

- In the past, with the prolonged shortage of demand and deflation, the labor force participation rate did not stop declining, and overcompetition among firms, as seen in their excessive services and excessive price cuts, constrained productivity growth. These sorts of hysteresis effects have been waning recently against the background of the labor market tightening.

- Going forward, it is possible that labor market conditions will tighten further, even if the use of robotic process automation (RPA) and artificial intelligence (AI) increases. This is because, amid expectations that the labor force will decrease, firms are expected to be in need of new employees as they provide new products and services brought through innovation and make up for a reduction in overtime work hours under working-style reforms.

- Labor shortages provide firms with a good opportunity to drive forward investment in human capital and software that aims to raise labor productivity. Removing regulations restricting competition, such as those on market entry, is also effective in promoting investment. Real wages will increase only after labor productivity rises through these initiatives.

- Although firms have been increasing their holdings of cash and deposits, the ratio to total assets at large firms has not been at an excessively high level, and instead is in a normal situation. However, an increase in their total assets -- the denominator of the ratio -- seems to mainly reflect cross-border mergers and acquisitions. This suggests that large firms have spent their cash and deposits overseas rather than on domestic business fixed investment.

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.

- Given that firms' price-setting stance plays an important role in determining future price developments, anecdotal evidence of individual firms has shown very encouraging developments. This is in line with the fact that the diffusion index (DI) for changes in output prices turned positive in the December 2017 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) for the first time since September 2008.

- The year-on-year rate of change in the CPI (all items less fresh food) has shown an uptrend. However, while the output gap has been positive, it seems to take some time to reach 2 percent as the inflation expectation formation is adaptive.

- There remain considerable uncertainties as to whether an increasing number of firms will shift their stances toward raising prices.

- Since there remains an excess supply capacity in capital stock and the labor market, the inflation rate has not risen, excluding the effects of a rise in energy prices. Under such circumstances, the dynamics through which inflation expectations rise in an adaptive manner have not been clearly in place.

II. Opinions on Monetary Policy

- Under the current monetary easing policy, financial conditions supporting firms' and households' spending have been highly accommodative.

- With regard to the conduct of monetary policy for the time being, it is appropriate for the Bank to maintain the current policy stance and pursue powerful monetary easing with persistence under the current policy framework toward achieving the price stability target of 2 percent.

- 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.

- As there is still a long way to go to achieve the price stability target of 2 percent, it is appropriate to maintain the current monetary policy.

- Since there is a long way to go for inflation to accelerate, it is judged as necessary to persistently conduct monetary policy so that highly accommodative financial conditions are maintained.

- Given the possibility that it may take a long time for inflation expectations to be raised through the adaptive expectation formation mechanism, it is important to persistently continue with powerful monetary easing in order to achieve the price stability target of 2 percent.

- Amid the situation of the inflation rate increasing toward 2 percent and the economy's medium- to long-term growth potential rising going forward, the effects of monetary easing measures will be enhanced. In conducting monetary policy, it will be necessary to take into account such changes in the environment as well as the side effects of the measures.

- Some actively argue that an exit from quantitative and qualitative monetary easing (QQE) needs to be considered in light of the situations abroad. Looking into the background behind the recent policy rate hike in South Korea, the inflation rate has been anchored at around 1.5 percent and the real GDP growth rate has been above 3 percent on average. Furthermore, outstanding household debt amounts to 90 percent against nominal GDP. In comparison with the situation in South Korea, it is too early for the Bank of Japan to change its monetary policy.

- When it is expected that economic activity and prices will continue to improve going forward, the situation may occur where the Bank will need to consider whether adjustments in the level of interest rates will be necessary under the framework of "QQE with Yield Curve Control," including from the perspective of strengthening the sustainability of the framework.

- Taking account of risk factors such as the consumption tax hike and a possible economic downturn in the United States, it is desirable to achieve the price stability target in fiscal 2018, and it is appropriate for the Bank to purchase JGBs so that yields on JGBs with maturities of 10 years and longer will be broadly lowered.

- With regard to the purchases of risky assets including exchange-traded funds (ETFs), given that stock prices and corporate profits have substantially improved and are expected to continue to develop firmly going forward, their policy effects and the possible side effects should be examined from every angle.

- The current monetary easing policy will contribute to raising labor productivity by providing economic conditions that can absorb a possible increase in unemployment in the course of the rise in labor productivity deriving from firm turnover and regulatory reform.

III. Opinions from Government Representatives

Ministry of Finance

- The government is in the process of finalizing the budget draft for fiscal 2018, with a view to achieving both economic revitalization and fiscal consolidation. In addition, it plans to formulate the supplementary budget for fiscal 2017.

- As for tax reform in fiscal 2018, 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 under "QQE with Yield Curve Control" in light 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 19 -- the real GDP growth rates for fiscal 2017 and 2018 are projected to be about 1.9 percent and about 1.8 percent, respectively, which are higher than those in the midyear economic projections released in July.

- The New Economic Policy Package was decided by the Cabinet on December 8. The government will tackle the enormous challenge of the declining birthrate and aging population by promoting "Supply System Innovation" and "Human Resources Development" as two wheels of a cart.

- 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.