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May 12, 2022

Bank of Japan

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

on April 27 and 28, 2022

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has picked up as a trend. It is likely to recover, with the impact of the novel coronavirus (COVID-19) and supply-side constraints waning and with support from an increase in external demand, accommodative financial conditions, and the government's economic measures, although it is expected to be under downward pressure stemming from a rise in commodity prices.

- Although attention should be paid, for example, to deterioration in households' sentiment, Japan's economy is expected to pick up, mainly for travel-related consumption, as the environment is becoming favorable for pent-up demand to materialize.

- Since the lifting of priority measures to prevent the spread of disease in March, it seems that the number of people going out and traveling has increased. However, reservations have been made mainly for the near term, up to the long holiday period from end-April through early May, and there is still a gap between demand in Japan and that in the United States and Europe, which has materialized since last year. It is hoped that there is room for consumption activity in Japan to expand since it has been constrained for more than two years.

- The main reason for deterioration in the terms of trade and a decline in households' purchasing power is a rise in import prices in contract currency terms, which is different from

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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.

price rises due to the yen's depreciation. This fact should be clearly communicated to the public.

- The yen's depreciation works positively in the current situation where the output gap and the unemployment gap are still large in absolute terms and underlying inflation is extremely low.
- The global economy has been recovering on the whole, but its pace has slowed due to three headwinds: the situation surrounding Ukraine, elevated inflation, and supply-side constraints.
- It is necessary to be vigilant regarding whether or not unexpected tail risks will arise in global financial markets due to the situation surrounding Russia and Ukraine.

Prices

- The year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is likely to increase temporarily to around 2 percent -- due to the impact of a significant rise in energy prices -- in fiscal 2022, when the effects of a reduction in mobile phone charges dissipate. Thereafter, however, the rate of increase is expected to decelerate because the contribution of the rise in energy prices to the CPI is likely to wane.
- Japan has seen upswings in prices due to the rise in energy prices, but the situation has not been one of elevated inflation, as observed in Europe and the United States; in Japan, underlying inflation, measured by the CPI excluding such factors as energy, has remained at an extremely low level.
- While Japan is currently facing low inflation and rising commodity prices simultaneously, underlying inflation has not risen with the output gap being negative and both GDP and employment not having returned to pre-pandemic levels.
- The year-on-year rate of change in the CPI is likely to be at around 2 percent for the time being from April, but a rate of increase that exceeds 2 percent is unlikely to be sustained given the household budget constraints.
- The year-on-year rate of change in the CPI is likely to be at around 2 percent in the first half of fiscal 2022, due mainly to a surge in commodity prices. From the second half, however, attention needs to be paid to downside risks brought about by possible declines in commodity prices.

- Although the possibility of the inflation rate reaching 2 percent has increased, the rise in inflation is due to higher import prices and therefore will be only temporary. Achieving the price stability target in a stable manner is difficult given developments in the output gap and inflation expectations.

- In terms of inflation excluding energy, for which prices fluctuate significantly, the year-on-year rate of change in the CPI is expected to moderately increase in positive territory on the back of improvement in the output gap, rises in medium- to long-term inflation expectations and wage inflation, and partly also of a pass-through of cost increases to food in particular.

- In a situation where developments in headline and underlying inflation have diverged significantly due to fluctuations in energy prices, it is appropriate for the Bank to present specific forecasts of the CPI excluding fresh food and energy in its *Outlook for Economic Activity and Prices* and carefully explain its assessment of the outlook for this CPI.

- The underlying inflation rate is likely to rise moderately due to increasing moves by firms to pass on a surge in commodity prices to retail prices, changes in firms' and households' mindset regarding prices, and a possible strengthening of upward pressure on wages amid intensifying labor shortage.

- Inefficiencies in trade and logistics resulting from the situation surrounding Ukraine, coupled with a surge in commodity and other prices, may continue to affect a wide range of goods prices in Japan.

- For sustained wage and price increases, it is important that large firms' moves, especially to increase wages, spread to small and medium-sized firms nationwide. In this context, the recovery in the number of people going out, developments in domestic investment, and efforts to strengthen growth potential should be closely monitored.

- Households' perceived inflation rate may have risen at a faster pace than the actual rate of change in the CPI. A pessimistic view on positive inflation could prevail among households as the pace of wage increases has not caught up with the pace of increase in perceived inflation. Therefore, it is necessary for the Bank to be more careful than before in communicating to the public regarding price developments and monetary policy.

- The recovery in Japan's economy depends on the course of COVID-19, but there remains a risk that downward pressure will be exerted on prices if medium- to long-term inflation expectations, wage inflation, and medium- to long-term growth expectations do not rise sufficiently while "standby" funds are not utilized.

II. Opinions on Monetary Policy

- Japan's economy is still on its way to recovery from the pandemic. Moreover, as Japan is a commodity importer, the rise in commodity prices leads to an outflow of income from Japan and thus exerts downward pressure on the economy. Given such developments in economic activity and prices, it is necessary for the Bank to continue with the current powerful monetary easing and thereby firmly support the economy.

- In the current situation where the output gap is negative and there is a significant risk that firms will become more cautious in making business decisions, it is appropriate for the Bank to make clear its stance that it will continue with the current monetary easing and thereby support the economy.

- The challenge of monetary policy in Japan is not to curb inflation, but to overcome inflation that is still too low.

- With the addition of Russia's invasion of Ukraine to the existing downside risks, the situation has further changed significantly. Against this backdrop, it is not appropriate for the Bank to make any big changes to its monetary policy.

- In the conduct of monetary policy, the effects that movements in commodity prices or exchange rates have on economic activity and prices, rather than the movements themselves, warrant consideration. It is necessary that the Bank maintain monetary easing to achieve the price stability target in a stable and sustainable manner.

- While communication to the public on the relationship between monetary policy and foreign exchange rates is important, one reason for the yen's recent depreciation is that economic conditions in Japan have been different from those in the United States and Europe, and it is not appropriate that the Bank change its policy with the aim of controlling foreign exchange rates.

- With a view to clarifying the Bank's stance to date of not accepting the long-term interest rate exceeding 0.25 percent and to avoiding a situation where daily operations are unnecessarily factored in by the market, it is appropriate for the Bank to announce in advance that it will conduct fixed-rate purchase operations at 0.25 percent every business day, unless it is highly likely that no bids will be submitted.

- The Bank should maintain monetary easing in a straightforward manner until the price stability target, accompanied by a virtuous cycle in which both prices and wages rise, is achieved in a sustainable and stable manner. In order to communicate such a policy stance without misunderstanding, it would be effective to clarify how the Bank conducts fixed-rate purchase operations.

- Reiterating the Bank's stance of continuing market operations in line with the target level of the long-term interest rate is likely to contribute to the formation of an appropriate yield curve and clarification of its accommodative policy stance.

- For the time being, while closely monitoring the impact of COVID-19, the Bank should support financing, mainly of firms, and maintain stability in financial markets, and should not hesitate to take additional easing measures if necessary. It is appropriate for the Bank to maintain the current forward guidance for the policy rates.

- 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.

- Achieving the price stability target of 2 percent during the projection period is difficult. In this situation, it is necessary for the Bank to carefully outline the significance of the target and the path toward its achievement, and continue to bear in mind that, as monetary easing becomes further prolonged, its sustainability will be increasingly important.

III. Opinions from Government Representatives

Ministry of Finance

- At the Group of Twenty (G20) and Group of Seven (G7) meetings in April, it was pointed out that Russia's aggression against Ukraine has led to, for example, surges in energy and food prices.

- The government has formulated the comprehensive emergency measures. It will make use of emergency funds for measures that need budget allocation. In addition, in order to be prepared for any unexpected fiscal demand, the government plans to submit the supplementary budget to the Diet during the current session.

- The government expects the Bank to conduct appropriate monetary policy toward achieving price stability in a sustainable manner while taking the impact of the situation surrounding Ukraine and COVID-19 into account and cooperating with the government.

Cabinet Office

- The government will swiftly implement the comprehensive emergency measures to respond urgently and agilely to the impact on people's daily lives and economic activity of soaring crude oil and other prices.

- The government will proceed with discussions to compile a grand design and an action plan of a new form of capitalism, as well as the Basic Policy on Economic and Fiscal Management and Reform 2022; through these efforts, it will address medium- to long-term issues and realize a virtuous cycle of growth and distribution.

- The government expects that the Bank will thoroughly explain to the public its intentions behind the decision at this MPM to clarify how it conducts fixed-rate purchase operations and will continue to conduct appropriate monetary policy based on developments in economic activity and prices as well as financial conditions.