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August 7, 2023

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting[1,2]
on July 27 and 28, 2023

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has recovered moderately. It is likely to continue to do so, supported by factors such as the materialization of pent-up demand, but there are extremely high uncertainties for Japan's economic activity and prices.

- Although the pace of recovery in overseas economies has slowed, domestic firms' and households' sentiment has been on an improving trend and firms' business fixed investment has increased. Many corporate executives have started to voice the need for wage hikes in view of recruitment and retention of employees. Positive developments have been seen in the income environment.

- Some firms have promised wage hikes not only for a single fiscal year but also for the period beyond. This suggests that such initiatives are necessary to recruit and retain employees in the current situation, and thus they are expected to further strengthen the virtuous cycle in the economy.

- There has been a polarization between those firms that seek to raise wages and prices through initiatives and investment to increase value-added and those that stick with their strategy of low wages, low value-added, and low prices. It cannot yet be said that the former type of firm has become the mainstream.

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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.

- There is a long way to go to achieve inflation accompanied by wage increases. In order not to lose a golden opportunity to dispel the deflationary mindset, the Bank needs to gain a good grasp of the situation regarding reforms in economic and wage structures and make a careful assessment of economic activity and prices so that there will not be a waning of appetite for investment among small and medium-sized firms, whose borrowings had increased during the COVID-19 pandemic.

- It is important that regional financial institutions provide follow-up support to small and medium-sized firms in order to strengthen their management resources, such as through business succession, which encourages transformation among these firms. In addition, in order to stimulate growth expectations and change the deflationary mindset, it is important to achieve growth in nominal GDP, as well as economic and wage structures in which nominal wages increase to a greater extent than do prices.

Prices

- The year-on-year rate of increase in the consumer price index (CPI) is likely to decelerate, with a waning of the effects of a pass-through to consumer prices of cost increases led by the past rise in import prices. Thereafter, the rate of increase is projected to accelerate again moderately.

- Although the inflation rate is projected to be pushed up by wage increases, it is likely to be pushed down by a decline in import prices and thus gradually decelerate. Prices are expected to turn around again after overseas economies pick up.

- Moves to rush the pass-through of cost increases to selling prices could pause in fiscal 2023, reflecting the projection that corporate profits will be at high levels due to the recent pass-through. That said, firms are expected to continue to take their time in passing on past cost increases to prices.

- The main reason why projected inflation for fiscal 2023 has deviated upward from the baseline scenario is that the cost-push from import prices has affected prices for longer than expected. That said, as signs of change have been seen in firms' wage- and price-setting behavior, close monitoring is warranted on their effects on prices. Determining whether wage hikes will continue next year will be a key issue.

- The year-on-year rate of change in the CPI is likely to fall below the 2 percent level in the second half of fiscal 2023. In order for this rate to then rise again to 2 percent and continue to stay at that level in a stable manner, it is important that a trend in which wage growth surpasses the rate agreed in this year's annual spring labor-management wage negotiations take hold.

- Price rises have been seen mainly in goods since last year due to cost-push factors. However, triggered by the high levels in base pay increases achieved this spring, more firms have started to consider wage hikes for the next fiscal year and beyond, and thus there is likely to be a new phase where wages and services prices continue to increase.

- Regarding the outlook for consumer prices, they could deviate upward from the baseline scenario, as firms' moves to pass on cost increases to selling prices become widespread against the backdrop of wage hikes that reflect a tightening of labor market conditions.

- The recent wage hikes and pass-through of cost increases by firms have a pent-up aspect, in that these moves had been suppressed for nearly three decades. Therefore, wages and selling prices could continue to rise at a pace that has not been seen in the past.

II. Opinions on Monetary Policy

- The Bank needs to patiently continue with monetary easing toward achieving the price stability target.

- In order to achieve the price stability target of 2 percent in a sustainable and stable manner, it is necessary for the Bank to keep supporting the momentum for wage hikes through continuation of monetary easing.

- As sustainable and stable achievement of the price stability target of 2 percent has not yet come in sight, there is still a significantly long way to go before revising the negative interest rate policy, and the framework of yield curve control needs to be maintained in line with the Bank's commitment that it has announced with regard to such framework.

- If upward movements in prices and inflation expectations continue, the effects of monetary easing will strengthen, while on the other hand, strictly capping 10-year Japanese government bond (JGB) yields at the 0.5 percent level could affect the functioning of bond markets and the volatility in other financial markets.

- Given that there are increasingly significant upside and downside risks to the outlook for prices, it is appropriate for the Bank to conduct yield curve control with greater flexibility in order to respond to these risks.

- There are extremely high uncertainties for economic activity and prices, as seen in projected inflation deviating significantly upward from the baseline scenario in a short period of time. In this situation, the Bank should conduct yield curve control with greater flexibility and thereby make preparations, so that it can successfully continue with monetary easing while nimbly responding to both upside and downside risks and taking account of factors such as market functioning.

- It is important to aim at keeping long-term interest rates stable at low levels in order to achieve the price stability target of 2 percent early. Until the likelihood of achieving the price stability target rises sufficiently, the Bank needs to maintain yield curve control while conducting it with greater flexibility.

- In order to ensure that monetary easing can be continued smoothly for as long as necessary, it is desirable that the Bank increase the flexibility of yield curve control to a certain extent in advance while it is able to do so without turmoil.

- As has often been pointed out, adjusting yield curve control has inherent difficulties. In conducting it with greater flexibility, it is appropriate to employ a framework that enables flexible responses tailored to the situation.

- Achievement of 2 percent inflation in a sustainable and stable manner seems to have clearly come in sight. In order to continue with monetary easing smoothly until an exit, the Bank should allow greater flexibility in its conduct of yield curve control.

- While conducting yield curve control with greater flexibility as a preventive measure against future risks, the Bank should maintain its basic stance that it will continue with monetary easing.

- When inflation expectations rise in a situation where long-term interest rates are capped, the positive effects of monetary easing will increase through a decline in real interest rates, while at the same time, the side effects, such as an increase in market volatility, will strengthen. Allowing to some extent a rise in long-term interest rates in response to the price environment will make real interest rates stable and enable the Bank to contain the side effects while maintaining the positive effects to a fair degree.

- In conducting yield curve control with greater flexibility, it is important to (1) let interest rates be determined by the market as much as possible, (2) work toward a securing of and recovery in market liquidity, and (3) prevent sharp fluctuations in interest rates. The Bank needs to conduct operations that take these factors into account.

- With the economic and price situation continuing to improve, some investors have held back from investing in bonds as they view that there are high uncertainties surrounding future interest rate developments. Taking into account the current situation, it is appropriate for the Bank to conduct monetary policy that is designed to give consideration to market functioning while maintaining accommodative financial conditions.

- The current price rises are no more than import inflation. In order to improve the momentum for wage hikes for small and medium-sized firms, where many of those employed in Japan work, it is important to enhance the earning power of these firms. It is more desirable to allow greater flexibility in the conduct of yield curve control after confirming a rise in their earning power.

III. Opinions from Government Representatives

Ministry of Finance

- The government considers that the proposals made at this MPM are aimed at enhancing the sustainability of monetary easing.

- The guidelines for budget requests for fiscal 2024 were approved by the Cabinet recently. In formulating the budget for fiscal 2024, the government, based on the Basic Policy on Economic and Fiscal Management and Reform 2023, will steadily promote integrated economic and fiscal reforms and work toward achieving both economic revitalization and fiscal soundness.

- The government expects the Bank to conduct appropriate monetary policy toward achieving the price stability target in a sustainable and stable manner while closely cooperating with the government.

Cabinet Office

- The government considers that the proposals made at this MPM are aimed at enhancing the sustainability of monetary easing measures that are necessary for the Bank to achieve the price stability target in a sustainable and stable manner. It deems it important for the Bank to carefully explain to the public its intention regarding the changes proposed at the meeting.

- The government expects the Bank to patiently continue with monetary easing toward achieving the price stability target of 2 percent in a sustainable and stable manner, accompanied by wage increases, while continuing to take account of developments in economic activity and prices as well as financial conditions.