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May 12, 2016

Bank of Japan

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

on April 27 and 28, 2016

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy is likely to be on a moderate expanding trend on the back of improvements in employment and income. However, its growth rate will be somewhat lower than the previous projection since sluggishness has been seen in exports and production due to the slowdown in emerging economies.

- Japan's economy has been on a moderate recovery trend. However, attention should be paid to negative effects of uncertainty over overseas economies and of volatile developments in financial markets on consumer and corporate sentiment, as well as to a risk that the impact of earthquakes in the Kyushu region might increase.

- Japan's economy has maintained its moderate recovery trend. Looking ahead, as the global economy is expected to recover moderately from the second half of fiscal 2016, Japan's economy is likely to continue its moderate recovery trend. Its real GDP growth rate for fiscal 2017 is projected to remain positive, although it is likely to be negatively affected by the scheduled consumption tax hike, while that for fiscal 2018 is projected to be in the range of 1-2 percent.

- Corporate profits have been at record high levels, and labor market conditions have remained extremely tight. These developments suggest that the economic conditions are fairly resilient.

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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.

- A virtuous cycle from income to spending is maintained in both the household and corporate sectors.

- Since the aggregate income formation is likely to lose momentum, a scenario in which a virtuous cycle will pick up steam does not seem to be increasingly persuasive.

- Since the turn of the fiscal year, a risk that the rate of change in the consumer price index (CPI) will be lower than expected has increased. However, I think the fact that observed inflation and expected inflation rates are currently significantly below the price stability target of 2 percent does not provide any particular impediment to the economic activity.

Prices

- Since the contribution of energy items to the year-on-year rate of change in the CPI is likely to remain negative and projections for GDP growth have been revised downward, the timing of the rate of change in the CPI reaching around 2 percent is likely to be somewhat later than previously projected, and now is projected to be during fiscal 2017.

- Although the contribution of energy items to the year-on-year rate of change in the CPI is expected to remain negative until the first half of fiscal 2017, the CPI inflation is likely to gradually accelerate and reach around 2 percent during fiscal 2017.

- With high corporate profits continuing to positively affect employee income, the mechanism in which inflation rises moderately accompanied by wage increases has been operating steadily.

- Base pay is expected to be revised upward for the third consecutive year, and wage increases have been spreading to small firms. These factors suggest that the mechanism in which inflation rises accompanied by wage increases has been operating steadily.

- With the output gap continuing to improve, the inflation rate is likely to accelerate. The timing of CPI inflation reaching around 2 percent is projected to be around the second half of fiscal 2017. In order to prevent the economy from being pulled back to deflation, the Bank should patiently stick with the current policy.

- Going forward, if consumer sentiment improves, firms' price-setting behavior toward price increases will likely become more pronounced again.

- The pace of decline in the unemployment rate has decelerated. Based on past experiences, I think 2 percent inflation is hard to achieve without a decline in the unemployment rate below 3 percent. Calling an unemployment rate of 3.0-3.5 percent a structural unemployment rate could lead to a misunderstanding that the unemployment rate cannot fall below this level.

- Considering various factors that put downward pressure on consumer prices, my outlook for CPI inflation is lower than that of the majority.

II. Opinions on Monetary Policy

Overall Assessment of Monetary Policy Management

- "Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate" has already produced its effects, in that it lowered various interest rates. Going forward, the policy effects will steadily spread to economic activity and prices.

- The Bank should continue with the current monetary policy. The main policy effects envisaged when it introduced "QQE with a Negative Interest Rate," such as declines in interest rates on housing loans and business lending, already have taken effect on the real economy. Financial institutions' reluctance to lend, which is a point of concern as a possible side effect, has not been observed thus far.

- The negative interest rate policy has brought about a decrease in long-term interest rates by around 30 basis points. Because of this, expected real interest rates substantially declined despite a decline in expected inflation rates. Thus, we should now examine what the effects of these large declines in real interest rates will have on the economy while closely monitoring developments in the global economy.

- Effects of the negative interest rate policy have been manifested in terms of the changes in interest rates. However, it will take some time until these effects spread to the economy and prices. At this moment, the Bank should carefully examine how the policy effects will permeate.

- For the time being, with regard to the negative interest rate policy, the Bank needs to examine the extent of the spread of policy effects to the real economy, and thus it is appropriate to maintain the current monetary policy.

- At this moment, it is appropriate to examine the extent of the permeation of policy effects.

- Risks to the outlook continue to be skewed to the downside. The Bank should take additional easing measures without hesitation in terms of three dimensions -- quantity, quality, and the interest rate -- if it is judged necessary for achieving the price stability target.

- Risks to both economic activity and prices are deemed to be skewed to the downside, and thus, if necessary, the Bank should take additional easing measures.

- Looking ahead, the Bank should explore additional easing measures if it is judged necessary for achieving the price stability target.

- Some argue that the negative interest rate policy is different in nature from QQE. They actually are the same, however, in that both policies aim at reducing the real interest rate to a level below the natural rate of interest.

- The Bank's price stability target should be interpreted flexibly. In pursuing monetary policy, the Bank should aim to achieve a situation in which household income and prices will increase in a balanced manner.

- As the Bank should assume that it will take considerable time until the price stability target is achieved, I think it should enhance the durability and sustainability of the current policy.

- With regard to the negative interest rate policy, I judge that its side effects outweigh the positive effects. Thus, I continue to dissent.

Effects on Market Operations and Financial Markets

- Supply-demand conditions in the Japanese government bond (JGB) market have become extremely tight. Going forward, it is highly likely that the Bank's JGB purchases will increasingly face difficulties. The Bank should take a flexible approach in its auctions for JGBs. Given that the effects of its JGB purchases have sufficiently been manifested as a decline in the yield curve, even though the amount of JGB purchases would fall short of the target as a result of the flexible approach, this would not cause any problem.

- Since the introduction of the negative interest rate policy, distortions in the pricing of the JGB market and potential limits to the Bank's JGB purchases seem more evident. The Bank should explore flexible approaches to its monetary base target and asset purchases. If under-subscriptions of JGB purchases were to happen on occasion, the Bank should provide thorough explanations so as to avoid a misunderstanding that this constitutes tapering of JGB purchases.

- The adoption of the negative interest rate policy with a multi-tier system for current account balances at the Bank has increased volatilities in long-term interest rates through the tightening of the JGB market conditions and unstable conduct of the Bank's JGB purchases, thereby negatively affecting the economy and financial markets.

Effects on the Functioning of Financial Intermediation

- Most of the arguments against negative interest rates concern a decrease in banks' profitability. Those who make these arguments forget that the only way for banks to gain stable profits is to revitalize the economy as a whole.

- The deterioration of banks' soundness under the negative interest rate policy could lead to a further decline in the potential growth rate through inefficient allocations of resources in the economy in the medium to long run. The Bank, by pursuing monetary policy with greater emphasis on the financial intermediation function, would facilitate productivity-enhancing initiatives by the government and firms, which will lead to an improvement in the potential growth rate, through efficient allocations of resources.

Funds-Supplying Operation to Support Financial Institutions in Disaster Areas Affected by the Kumamoto Earthquake

- Since the Kumamoto Earthquake occurred, the Bank has devoted its utmost efforts to maintaining the financial infrastructures. By introducing a funds-supplying operation to support financial institutions in disaster areas affected by the Kumamoto Earthquake, the Bank should continue to contribute to restoration and rebuilding of these areas.

III. Opinions from Government Representatives

Ministry of Finance

- The government will proceed with its initiatives regarding the supplementary budget for responding to the Kumamoto Earthquake so that the budget can be submitted to the Diet in mid-May.

- The government considers the Bank's introduction at this meeting of a funds-supplying operation to respond to the Kumamoto Earthquake as entirely appropriate.

- The government will make efforts to deliver the budget for fiscal 2016 to the people as swiftly as possible through an earlier implementation of the budget, and will appropriately respond to the downside risks to the economy.

- The government continues to expect the Bank to work toward achieving the price stability target in light of economic activity and prices.

Cabinet Office

- The government expects that the Bank will steadily work toward achieving the price stability target of 2 percent in light of economic activity and prices.

- The government deems it important that the Bank continue to thoroughly communicate its negative interest rate policy, to make efforts such that its policy effects will be fully realized, and to fully explain the reasons for deferring the timing of the year-on-year rate of change in the CPI reaching the price stability target.

- The government expects that, with the funds-supplying operation decided at this meeting to support financial institutions in the disaster areas, restoration and rebuilding in these areas will be fully supported from the financial aspect.