Not to be released until 8:50 a.m. Japan Standard Time on Thursday, December 29, 2016.

December 29, 2016

Bank of Japan

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

on December 19 and 20, 2016

I. Opinions on Economic and Financial Developments

Overseas Economies and Global Financial Markets

- With regard to overseas economies, the signs of slowdown in emerging economies have diminished and an improvement in advanced economies has been spreading to the corporate sector. A pick-up in manufacturing has been seen globally.

- Since the U.S. presidential election, interest rates in the United States have risen, while those in Japan have remained stable at low levels under the Bank's yield curve control. Thus, the yield differential has widened, and the yen's depreciation against the U.S. dollar as well as a rise in stock prices in Japan have continued to be observed.

- It should be noted that there is a possibility that the U.S. economy will further accelerate owing to economic measures to be taken by the new administration. Meanwhile, the flow of funds related to emerging economies warrants close attention.

- I believe financial market developments after the U.S. presidential election are fundamentally supported by the stabilization of crude oil prices and firmness in the real economy. However, as these developments are also partly led by speculations, there is a good possibility that markets would adjust considerably.

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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.

Domestic Economy

- The economic recovery in Japan has taken hold more firmly, as exports and industrial production have picked up and an improvement in private consumption has started to become evident.
- Exports and industrial production in Japan have picked up with the signs of slowdown in emerging economies diminishing. In addition, an improvement in private consumption has become evident.
- Japan's economy is on a moderate recovery trend. Exports have started to pick up recently and resilience in private consumption has increased. Japan's economy is highly likely to maintain relatively high growth as the positive effects resulting from a set of the government's stimulus measures and the recovery in overseas economies continue.
- Japan's economy is expected to accelerate somewhat, led mainly by exports and industrial production. Private consumption, which has been lagging, is likely to increase its resilience on the back of improvement in consumer sentiment.
- Japan's economy has continued its moderate recovery trend. As some economic indicators show signs of improvement, it is important to support such developments and turn them into strong momentum that is self-sustaining.
- Economic conditions at present resemble those from 2013 through the first half of 2014 in many aspects, when the virtuous cycle in the economy and the acceleration of the inflation rate were observed. Japan is at a critical juncture with regard to achieving price stability and sustainable growth.
- As business fixed investment and private consumption continue to recover on the back of the yen's depreciation and wealth effects stemming from a rise in stock prices, the growth rate for fiscal 2017 will accelerate further, supported also by the government's large-scale stimulus measures.
- Business fixed investment was revised upward in the revised GDP statistics, and this suggests that firms' willingness to invest in research and development with the aim of producing new products has been maintained at a high level.
- With regard to the outlook for Japan's economy, attention should be paid to (1) household sentiment under a rise in crude oil prices and the yen's depreciation, (2) the effects of a severe labor shortage, and (3) the effects of volatility in the foreign exchange market.

Prices

- There are some indicators of inflation expectations that have bottomed out or improved somewhat, but such expectations have remained in a weakening phase on the whole.

- Inflation expectations and the output gap have been on rising trends from a somewhat longer-term perspective. As oil prices and some other commodity prices are already on rising trends, the inflation rate is expected to increase as the downward pressure on prices gradually dissipates.

- Depending on market developments, the year-on-year rate of increase in the consumer price index (CPI) for all items less fresh food is likely to accelerate somewhat.

- The recent yen depreciation only pushes up prices in the short run, and I do not think it would raise the underlying trend in prices.

II. Opinions on Monetary Policy

- Under the framework of yield curve control, the yield curve has been formed smoothly in a manner consistent with the guideline for market operations.

- "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" has been functioning as intended thus far, and is contributing to economic recovery and price increases.

- As there is still a long way to go to achieve the price stability target of 2 percent, it is important for the Bank to firmly maintain the current monetary policy stance so that the policy would produce its full effects, with the aim of achieving the target at the earliest possible time.

- The current policy is designed to take full advantage of the tailwind to enhance monetary easing effects, thereby strengthening the momentum toward achieving the 2 percent target. The Bank should firmly maintain the current monetary policy stance.

- Considering experiences such as the Federal Reserve's removal of monetary accommodation at the time of the Great Depression and Japan's termination of the zero interest rate policy as well as of quantitative easing (QE) -- all of which took place too early -- the Bank should continue with "QQE with Yield Curve Control" at the current levels of the policy rate and the long-term interest rate target for a considerable period of time, in order to achieve the price stability target of 2 percent.

- As a virtuous cycle in the economy has been in place, the Bank should continue with the current monetary policy so that it can contribute to the long-running battle to overcome deflation.

- When the nominal long-term rate is controlled at zero percent, positive shocks to the economy amplify the effects of monetary accommodation. The implication of the Bank's inflation-overshooting commitment that allows the observed CPI to exceed 2 percent will be recognized when prices are actually on the rise, although the implication is not perceived in the absence of inflation. The policy effects will strengthen as there will be a growing understanding of the aim of the policy framework introduced in September. The Bank should conduct market operations so that 10-year Japanese government bond (JGB) yields are kept at zero percent. The current situation presents a good opportunity to achieve the price stability target of 2 percent.

- Japan's interest rates have remained relatively stable amid the global rise in interest rates. Such divergent developments in rates have highlighted the policy effects of the Bank's monetary easing measures, reinforcing its announcement effects. This is expected to contribute to raising inflation expectations.

- JGB purchases should be conducted so that the entire yield curve will be formed in a manner consistent with the guideline for market operations, taking into account not only the level of the interest rates but also the speed and momentum of their changes, as well as factors behind them.

- Under the current policy framework, close communication between the Board, which decides the guideline for market operations, and the Market Operations Desk is critically important. In the conduct of market operations, the Desk should have some degree of discretion under the guideline. At the same time, in deciding the guideline, the Board should carefully consider market developments and participants' views on them, obtained through the conduct of operations by the Desk.

- Instead of the current policy framework, the Bank should set the amounts of increase in its assets as the operating target and reduce the amounts incrementally so that the sustainability of the Bank's asset purchases and the stability of financial markets will be enhanced. The volatility in the foreign exchange rates and stock prices has risen significantly under yield curve control. Furthermore, the fact that the Bank had to use the fixed-rate operation in an early stage has proved the difficulty of implementing yield curve control. The fixed-rate operation is not very effective when there is no subscription for them. The recent increase in the amount of purchases of super-long-term JGBs also underlined my concern since the outset that there is a considerable risk that the Bank would end up accelerating the pace of JGB purchases under the framework of yield curve control.

- As I am in dissent with the target level of 10-year JGB yields being set at around zero percent, the shape of the yield curve that would best suit the current state of economic activity and prices should be a little steeper. Regarding the control of long-term interest rates, the Bank should raise the target level in order to accommodate the actual rise in interest rates in a behind-the-curve manner, if it judges that the market developments reflect the improvement in economic activity and prices going forward. In markets, it is widely believed that long-term interest rates are allowed to move in the range of negative 0.1 percent to positive 0.1 percent under the current target level of "around zero percent," but I believe the range should be larger. As the Bank cannot fine-tune long-term interest rates, they should be allowed to fluctuate in a larger range, and to the upside in particular.

III. Opinions from Government Representatives

Ministry of Finance

- The government is in the process of finalizing the budget draft for fiscal 2017. In addition, it plans to formulate the third supplementary budget for fiscal 2016.
- As for tax reform in fiscal 2017, 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 for fiscal 2017 -- which was approved by the Cabinet today -- the real and nominal GDP growth rates were projected to be about 1.5 percent and about 2.5 percent, respectively, and the year-on-year rate of increase in the CPI was expected to be around 1.1 percent.

- At the Council for the Realization of Work Style Reform, the prime minister asked the industrial sector to conduct wage increases of at least the same extent as this year's. Today, the government will submit a draft guideline for providing equal pay for equal work.
- The government expects that the Bank will steadily work toward achieving the price stability target of 2 percent, in light of developments in economic activity and prices, as well as financial conditions.