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February 8, 2017

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on January 30 and 31, 2017

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has continued its moderate recovery trend. Business fixed investment has been on a moderate increasing trend and private consumption has been resilient. As for the outlook, the economy is likely to continue growing at a pace above its potential.
- Since the second half of 2016, Japan's economic recovery has strengthened. Positive synergy effects are being produced by improvement in overseas economies, economic stimulus measures by the government, and enhanced monetary easing.
- Positive developments in the real economy have been increasingly observed recently, such as (1) a pick-up in exports amid moderate growth in overseas economies, (2) an upturn in private consumption backed by improvement in labor market conditions as well as a rise in real employee income, and (3) an increase in business fixed investment, due partly to an improvement in business sentiment.
- Japan's economy has continued its moderate recovery trend. Although the pace of its recovery has shown signs of accelerating, this change is not sufficiently clear; thus, the economy is likely to continue growing at a pace that is somewhat above its potential.
- The Consumption Activity Index shows that private consumption has been rising, having hit the bottom in mid-2016. The propensity to consume, which had been declining continuously,

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.

is expected to bottom out in due course. This is attributable to higher replacement demand for durable goods, stability in stock prices, and an improvement in consumer sentiment.

- It is widely expected that energy prices are stabilizing, which is likely to have favorable effects on Japan's economy.
- Consumption has been picking up but still lacks momentum. I am closely watching whether it will continue to recover steadily after the pent-up demand dissipates. The scheduled decline in pension receipts next fiscal year may affect consumer sentiment.
- Although overseas economies have turned to a moderate recovery, uncertainties are likely to persist, such as the economic policy of the new U.S. administration and its impacts on emerging economies, as well as national elections to be held in European countries.
- The degree of uncertainty regarding the U.S. economy is likely to remain high.
- Looking ahead, there will still be uncertainties for some time over the outlook for the global and Japanese economies. These include the policy stance of the new U.S. administration and how the negotiation of Brexit will play out.
- It is the downside risks that should be noted in the short run; however, as market participants and economic entities factor them in to a certain extent, the economy could deviate upward from the baseline scenario if they are perceived as diminishing.

Prices

- The year-on-year rate of change in the consumer price index (CPI) is likely to increase toward 2 percent as the output gap improves and medium- to long-term inflation expectations rise. The timing of the CPI inflation rate reaching around 2 percent will likely be at the end of the projection period of the *Outlook for Economic Activity and Prices* (Outlook Report) -- that is, around fiscal 2018.
- The inflation rate is likely to turn positive, mainly on the back of (1) dissipation of downward pressure on prices stemming from a decline in commodity prices and (2) a tightening of the output gap. However, it would take some time for the inflation rate to accelerate, as the formation of inflation expectations is adaptive.

- In light of the findings of the comprehensive assessment that the adaptive component plays a large role in the formation of inflation expectations in Japan, it is very unlikely that inflation expectations will increase significantly within the projection period of the Outlook Report.
- It is disappointing that the underlying trend in the monthly CPI inflation rate has been more or less flat, despite an improvement in economic developments. I believe that the inflation rate will remain largely below 2 percent during the projection period of the Outlook Report.

II. Opinions on Monetary Policy

- The momentum toward achieving the price stability target of 2 percent is maintained but is not yet sufficiently firm, and thus developments in prices continue to warrant careful attention. Therefore, the Bank should continue with the current monetary easing.
- Since there is a long way to go to achieve the price stability target of 2 percent, the Bank should continue with the yield curve control, under which the short-term policy interest rate is set at minus 0.1 percent and the target level of yields on 10-year Japanese government bonds (JGBs) is around 0 percent, even though the interest rates in the United States have been rising.
- Although economic and price developments in Japan have been improving steadily, the Bank should be prudent in changing the monetary policy hastily, considering such factors as uncertainties surrounding overseas economies. For the time being, it should monitor the policy effects under the current framework with patience.
- As a virtuous cycle in the economy is taking hold, the Bank should continue with the current monetary policy so that it can contribute to the long-running battle to overcome deflation.
- Some market participants speculate that the Bank might consider raising the target level of the long-term interest rate in response to such factors as a rise in the U.S. long-term interest rates; however, since there is still a long way to go to achieve the price stability target of 2 percent, firmly maintaining the current monetary policy stance is of the utmost importance.
- The current monetary policy framework has exerted its intended effects. The Bank's implementation of the current framework, including flexible adjustment of market operations, has been well received by market participants.
- Given heightened uncertainty in the global financial markets, a small event could trigger a substantial change in the perception of the markets regarding the level of long-term yields. In

such situations, concerns of the markets over the Bank's controllability of the yield curve tend to be growing. It is therefore important to give some discretion to the Market Operations Desk, which will conduct market operations in a flexible manner.

- Under yield curve control, the amount, timing, and frequency of the JGB purchases are determined practically so as to achieve the target level specified by the guideline for market operations. The Bank should make clear to the markets that daily conduct of market operations has no implications for the monetary policy stance going forward.
- The Bank is controlling not only short-term but also long-term interest rates in order to achieve the price stability target of 2 percent in a stable manner. Therefore, if the long-term interest rates in the United States rise substantially while the inflation rate in Japan remains low, it will be more difficult for the Bank to control the long-term interest rate at the target level. In this regard, reconsidering the framework of yield curve control has a substantial benefit. The Bank should instead set the amount of increase in its assets as the operating target and reduce the amount incrementally in an orderly manner so that the sustainability of the Bank's policy and the stability of financial markets will be enhanced.
- I am in dissent with the target level of 10-year JGB yields being set at around 0 percent. It is my belief that the yield curve that would be most appropriate for achieving favorable conditions in economic activity and prices should be a little steeper. In theory, the downward pressures on yields will increase due to the stock effects as the Bank continues with JGB purchases. Therefore, the Bank should reduce the amount of purchases by carefully monitoring the market reactions, so as to facilitate the formation of a yield curve that is consistent with the guideline for market operations. When the long-term interest rates rise as a result of pricing in the future improvement in economic activity and prices, it would be prudent to adjust monetary policy by following the market developments. Meanwhile, the amount of purchases of treasury discount bills (T-Bills) should be further reduced by taking account of the market developments.
- The negative interest rate policy has had positive effects, such as an increase in housing investment, an increase in bank lending, and lower issuance rates for corporate bonds. Such positive effects, however, were offset by the slowdown in the global economy that led to lower interest rates globally, bringing about the yen's appreciation and the stock price declines, and thereby resulting in the sluggish exports and production. Thereafter, along with the recovery in the global economy, the yen has depreciated with the rise in stock prices.

These facts seem to support my interpretation that the positive effects of the negative interest rate policy were offset by the slowdown in the global economy.

III. Opinions from Government Representatives

Ministry of Finance

- The budget for fiscal 2017 and the third supplementary budget for fiscal 2016 were submitted to the Diet recently.
- With the budget for fiscal 2017, the government can achieve both economic revitalization and fiscal consolidation. Obtaining approval from the Diet for the budget at the earliest possible time is the key to stimulus measures, and thus the government will make efforts to make sure this happens.
- The government expects the Bank to continue to work toward achieving the price stability target under "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," in light of developments in economic activity and prices, as well as financial conditions.

Cabinet Office

- The government will proceed with the amendment of the acts regarding equal pay for equal work and a regulatory limit on overtime work. The Japan Business Federation (Keidanren) recently released the Summary of the 2017 Report of the Committee on Management and Labor Policy, which well reflects the request from the prime minister, according to its chairman. The government released the Economic and Fiscal Projections for Medium- to Long-Term Analysis. It also will advance statistics reform, with the relevant ministers working as one.
- 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.
- The government expects the Bank to continue to fully explain the situation of its monetary policy management and the outlook for prices.