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September 29, 2017

Bank of Japan

## Summary of Opinions at the Monetary Policy Meeting<sup>1,2</sup> on September 20 and 21, 2017

### I. Opinions on Economic and Financial Developments

#### *Overseas Economies and Global Financial Markets*

- Overseas economies have continued to grow at a moderate pace on the whole. Global trade activity has continued to recover, and domestic demand in many economies has been firm.
- It is expected that, if the outcome of the federal election in Germany turns out to be in line with market expectations, this will lead market participants to reassess the outlook for the euro area economy more positively and further improve growth expectations in the area. While the European Central Bank's (ECB's) monetary policy is likely to shift toward normalization, it is reassuring that concerns over the financial sector in Europe have abated somewhat.
- Careful attention needs to be paid to whether the increasing trend in China's producer price index (PPI) suggests that the worldwide disinflationary trend will change.
- Investors' risk aversion to geopolitical risks has been seen only in part, but more attention needs to be paid than before to the possibility that market participants' sentiment will change suddenly.
- While the heightened tension regarding the situation in North Korea has often led to the appreciation of the yen thus far, such market reaction has become muted recently. I have felt

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<sup>1</sup> English translation prepared by the Bank's staff based on the Japanese original.

<sup>2</sup> "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.

that there is no logical reason why such situation should lead to the appreciation of the yen, and suppose that more market participants have started to take this view.

### *Domestic Economy*

- Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating.
- Japan's economy is expanding moderately. It will likely continue improving, supported by three main factors: growth in overseas economies; the government's economic measures; and monetary easing policy.
- Japan's economy is expanding moderately. Domestic demand such as private consumption and business fixed investment has been on an increasing trend, and an uptrend in wages is likely to take hold gradually on the back of tightening labor market conditions.
- In light of historical data, the ratio of the amount outstanding of firms' cash and deposit holdings to total assets has approached the level that firms deem most appropriate. Thus, firms are expected to gradually increase the proportion of funds to be spent for business fixed investment as well as research and development out of total internal reserves.
- The labor share has been at a low level with firms' deposits and internal reserves accumulating. It is essential that those funds be used for future investment and employees' wages.
- In the household sector, in a situation where the burden of households is projected to increase, the current rise in income is unlikely to create an expectation that income will rise in a sustainable manner. In the corporate sector, capacity utilization rates and growth expectations have not increased enough. Considering these aspects, the pace of increase in domestic private demand will likely remain moderate.

### *Prices*

- The year-on-year rate of change in the consumer price index (CPI) is likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations.

- Unless a significant adverse shock occurs, such as a further heightening of geopolitical risks, Japan's economy will grow moderately, leading to wage increases and a gradual rise in the inflation rate.
- It is likely that firms will eventually need to reflect in their sales prices the increased costs that they cannot absorb through labor-saving investment and streamlining of their business processes.
- Mainly in labor-intensive sectors such as eating and drinking services, there has been a gradual but steady increase in cases where firms make efforts to raise their prices and other firms follow suit.
- Recently, some firms have been raising such prices as real estate rents in city centers and charges for home delivery services.
- An increase in labor force participation rates and firms' efforts to raise labor productivity are factors that constrain increases in wages and prices. Nevertheless, as these can be considered part of the adjustment process accompanying positive structural changes, the current situation should not be viewed too pessimistically.
- The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase gradually toward 2 percent. However, reaching 2 percent is likely to take some time as firms' deflationary mindset has been persistent and their price-setting stance has been cautious.
- Although the year-on-year rate of change in the CPI is likely to increase for the time being, reflecting developments in crude oil prices and foreign exchange rates, the possibility of the rate of change increasing toward 2 percent from 2018 onward is low at this point since there remains an excess supply capacity in capital stock and the labor market.

## **II. Opinions on Monetary Policy**

- The momentum toward achieving the price stability target of 2 percent is maintained. However, as there is still a long way to go to achieve the target, it is important for the Bank to pursue the current powerful monetary easing with persistence.
- The momentum toward achieving the price stability target of 2 percent continues to be maintained. In order to sustain such favorable developments as long as possible, it is appropriate for the Bank to persistently pursue powerful monetary easing under the current

guidelines for market operations, thereby supporting improvement in economic activity and prices.

- The Bank should continue with the current monetary policy with the aim of persistently encouraging the virtuous cycle to take hold and completely overcoming deflation, while making efforts to gain people's understanding of its policy.
- The effects of monetary easing policy under the current framework will be further enhanced going forward through a rise in the natural rate of interest and a decline in real interest rates, as Japan's economy increases its growth potential and the inflation rate rises.
- It is best for the Bank to persistently continue with the current monetary easing policy in order to achieve the price stability target of 2 percent, although it will take time. However, the Bank needs to bear in mind the possibility that, if geopolitical risks heighten further, it may consider making policy adjustments as appropriate to prevent the deflationary mindset from emerging again.
- One of the reasons why the Bank commits itself to achieving the price stability target of 2 percent is that it is difficult to accurately grasp the actual situation of economic activity and the level of the structural unemployment rate. If the Bank had halted monetary easing based on the assumption that the structural unemployment rate is estimated to be 3.5 percent, the current unemployment rate of 2.8 percent would never have been achieved. By directly setting the inflation rate as the price stability target, a lower unemployment rate and a rise in wages have been achieved without causing an asset bubble. Labor shortage has induced firms to devote themselves to streamlining their business processes and making labor-saving investment.
- Given the current level of inflation rate, it is possible that it will take some time to achieve the price stability target. The longer this takes, the higher the uncertainty in the external environment. Going forward, it is necessary to take into account both the sustainability of the policy and the time constraint in achieving the target.
- A year has passed since the introduction of "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control." Going forward, the Bank should monitor the functioning of financial intermediation more carefully than before.
- It is important to keep examining financial conditions, while continuing the dialogue with market participants, so that financial institutions will be well equipped with financial strength

and risk-hedging measures when the current monetary policy reaches the phase of shifting toward normalization.

- As a consumption tax hike is scheduled in October 2019, it is necessary to further stimulate the aggregate demand by additional monetary easing so that the price stability target will be achieved in a stable manner.

### **III. Opinions from Government Representatives**

#### ***Ministry of Finance***

- The application of budget requests for fiscal 2018 was closed recently, and the total amount of the budget requests and demands for the general account turned out to be about 100.96 trillion yen.
- In formulating a budget, the government will closely examine requests and demands and draw up a budget that focuses on high-priority issues including measures to promote human resources development, thereby working on achieving both economic growth and fiscal consolidation.
- 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***

- The real GDP growth rate for the April-June quarter of 2017 registered positive growth for the sixth consecutive quarter, representing high growth last seen in the January-March quarter of 2015.
- With regard to human resources development, the government set up the Council for Designing 100-Year Life Society and held the first meeting on September 11. It will advance discussion, with a sense of urgency, to compile an interim report by the end of this year, followed by a basic concept document scheduled for release in the first half of next year.
- The government expects that the Bank will work steadily toward achieving the price stability target of 2 percent in light of developments in economic activity and prices, as well as financial conditions.