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August 8, 2018

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on July 30 and 31, 2018

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Going forward, it is likely to continue expanding, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending.
- Japan's economy is expanding moderately. In fiscal 2018, the economy is likely to continue growing at a pace above its potential. From fiscal 2019 onward, the growth pace is projected to decelerate temporarily, due mainly to the effects of the scheduled consumption tax hike, and recover gradually thereafter.
- As uncertainties for the time being, it is necessary to pay attention to the effects on economic activity of the heavy rain in July and the record-breaking heat wave continuing nationwide.
- With regard to the risk balance in the global economy, there likely are growing downside risks stemming from trade friction between such economies as the United States and China as well as from currency fluctuations.
- The effects on the global economy of the depreciation of emerging economies' currencies as well as the developments in policy rate hikes in those economies warrant close attention.

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.

Prices

- It likely will take more time than expected to achieve 2 percent inflation, mainly because the mindset and behavior based on the assumption that wages and prices will not increase easily have been deeply entrenched. However, as the output gap remains positive, many of the factors that have been constraining inflation are likely to be resolved gradually.
- As firms' stance gradually shifts toward further raising wages and prices and as further price rises come to be observed widely, with the output gap remaining positive, medium- to long-term inflation expectations are projected to rise gradually. The year-on-year rate of change in the consumer price index (CPI) is likely to increase gradually toward 2 percent, although it will take more time than expected.
- The year-on-year rate of increase in the CPI (less fresh food) is likely to continue accelerating moderately. Nevertheless, as such developments have been weak and unstable, it is projected that achieving 2 percent inflation will take some time.
- It is less likely that the output gap will continue to widen within positive territory, and inflation expectations have continued to show relatively weak developments. Under the current policy, the possibility of the inflation rate increasing gradually toward 2 percent is low.
- Expansion in the economy's supply capacity, such as improvements in the labor force participation rate and labor productivity, has been easing upward pressure on wages and prices recently. However, this change will contribute to the sound development of Japan's economy as a whole, and in the long term, raise growth expectations and potentially exert upward pressure on wages and prices through dissipation of the deflationary mindset. We should not be too pessimistic about the current economic situation.
- After the introduction of quantitative and qualitative monetary easing (QQE), productivity and employment have improved more than initially expected. In the medium to long term, a rise in productivity and an expansion in employment will increase people's willingness to invest or spend and lead to a rise in inflation, although this will take time. In the short term, a rise in productivity will constrain a rise in the inflation rate.
- The *Outlook for Economic Activity and Prices* (Outlook Report) explains that price developments are determined by the aggregate supply-demand balance and medium- to long-term inflation expectations. On the other hand, there are still explanations of price developments among the public that rely on adding up prices of individual items and on

structural factors. A thorough explanation is necessary in order to fill in the gap between these explanations.

II. Opinions on Monetary Policy

- Although it will take time to achieve the price stability target, it is necessary to persistently continue with the current powerful monetary easing as the momentum toward 2 percent inflation is maintained.
- It is important to make powerful monetary easing sustainable so that it can be continued persistently toward achieving the price stability target.
- It is important to maintain somewhat tight supply-demand conditions in the economy as long as possible. To this end, it is essential to pay close attention to the side effects stemming from the prolonged monetary easing policy and continue to examine carefully whether there is room to review the policy framework, with a view to minimizing such side effects as much as possible.
- The Bank should introduce forward guidance for policy rates and strengthen its commitment to achieving the price stability target, in order to ensure public confidence in its strong stance toward achieving the target.
- It is extremely important to further strengthen the framework of monetary easing by introducing forward guidance as a new measure.
- A policy is judged based on its consequences. Since price developments are weak at present, now is the right time to strengthen the Bank's commitment. While I expect that the new policy measures will raise the inflation rate, it is necessary to continuously examine their effects.
- Instead of strengthening the framework for persistently continuing with monetary easing, it is necessary to strengthen monetary easing itself so that it will not be persistent. It is important to design forward guidance to stimulate aggregate demand and inflation expectations so that monetary easing will not become prolonged.
- In a situation where monetary easing is expected to continue, conducting yield curve control and asset purchases in a more flexible manner should be considered in order to adjust the policy framework so that it can function in a competent manner over the period of the easing's duration.

- It is appropriate to bear in mind that the long-term yields may move upward and downward at about double the range of around plus or minus 0.1 percent since the introduction of yield curve control.
- Controlling the long-term yields in a flexible manner is likely to contribute to maintaining and improving market functioning. Even if interest rates rise somewhat from the current level, its effects on economic activity and prices are likely to be limited; on the other hand, such a rise is expected to be effective in alleviating the cumulative impact on the functioning of financial intermediation and enhancing the sustainability of the Bank's policy. Referring to the recent developments in long-term interest rates in major economies, it can be considered appropriate for interest rate control in Japan to allow the yields to move upward and downward by around 0.25 percent.
- If most Policy Board members agree to bear in mind that the long-term yields may move upward and downward at about double the range of around plus or minus 0.1 percent, this should be made clear at the press conference after this meeting.
- At this point, when medium- to long-term inflation expectations are weak, making policy adjustments that could allow the long-term yields to rise may lead to an increase in real interest rates and thereby contribute to sluggish prices.
- Allowing flexibility in the purchase amount of exchange-traded funds (ETFs) is appropriate because it enables effective purchases while enhancing the sustainability of the policy.
- Through the strengthening of the framework for continuous powerful monetary easing, the Bank's commitment to achieving the price stability target will be further enhanced.
- By strengthening the framework for continuous powerful monetary easing, the Bank aims to prepare for continuing monetary easing much longer. Specifically, the Bank will enhance the sustainability and flexibility of its monetary policy by conducting the policy measures thoroughly based on the initial policy intention of QQE that implies some flexibility. These measures will make the path toward achieving the price stability target more certain.
- Without implementation of QQE, there would have been a possibility that (1) neither an increase in lending nor a decrease in credit cost among financial institutions would have materialized and (2) realized sales gains on bonds and stocks would have been smaller. Some expect that, in the case of a rise in interest rates, only the rates on investment will increase without any changes in foreign exchange rates as well as prices of stocks and bonds, or a

decline in firms' willingness to borrow. However, this will not happen if we consider the economy as a whole.

- In continuing with the current monetary easing, it is important to (1) take into account in a compounded manner the two different time frames in which both of its positive and negative effects appear, and (2) make flexible policy adjustments depending on developments in economic activity and prices as well as financial conditions while examining the risks considered most relevant to the conduct of monetary policy.
- When making assessments on the financial system and market functioning, it is necessary to deepen discussion of how they should be assessed in line with the price stability target, rather than focusing on individual indicators.

III. Opinions from Government Representatives

Ministry of Finance

- The government welcomes the proposals presented by the Bank's staff at this meeting as measures that will strengthen the framework for continuous powerful monetary easing, and expects the Bank to make an appropriate judgment in taking necessary measures for that purpose.
- The government expects the Bank to continue to thoroughly and actively explain developments in its conduct of monetary policy.
- The guidelines for budget requests for fiscal 2019 were approved by the Cabinet on July 10. The government will continue to take all possible measures in responding to the effects of the Heavy Rain in July 2018.
- The government expects the Bank to continue to work toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions.

Cabinet Office

- The government expects the Bank to steadily pursue monetary easing toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions.

- The government recognizes that the measures to strengthen the framework for monetary easing were proposed at this meeting in order to further clarify the Bank's intention to continue with monetary easing. The government deems it important that the Bank thoroughly explain its thinking to the public.
- The government will proceed with initiatives toward reinforcing the competitiveness and growth potential of Japan's economy.