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December 27, 2021

Bank of Japan

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

on December 16 and 17, 2021

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has picked up as a trend, although it has remained in a severe situation due to the impact of the novel coronavirus (COVID-19) at home and abroad.

- Although supply-side constraints have persisted and there are uncertainties over the COVID-19 variants, a pick-up trend in Japan's economy has been intensifying on the back of improvement in consumer sentiment while public health measures have been lifted in stages.

- Although the global economy continues to be subject to uncertainties due to the spread of the COVID-19 variants, there is no sign at present of a sharp drop in demand.

- Japan's economy is likely to recover as downward pressure stemming from COVID-19 on services consumption and the effects of supply-side constraints wane.

- It was confirmed in the December 2021 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) that firms are planning to increase business fixed investment. However, their plans show that there is lack of strength in investment for growth areas that leads to innovation as well as investment by small and medium-sized nonmanufacturing firms, where many of the employees in Japan work.

- Corporate profits could be negatively affected not only by deterioration in the terms of trade but also by logistics disruptions and prolonged supply-side constraints. If cost increases are

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.

not fully passed on to selling prices under the circumstances, there is an increasing risk that profits will not be distributed to capital or labor smoothly.

- With the government examining ways to encourage firms to increase wages, it is hoped that a virtuous cycle will be created where corporate activities are boosted despite continued vigilance against COVID-19 and wages and prices increase steadily without a large time lag between each other, thereby leading to active consumption behavior.

- Since Japanese firms have pushed forward with "local production for local consumption" in overseas markets, the positive effects that the yen's depreciation exerts on business performance and stock prices have become smaller compared with the past.

- Risks to the global economy include the spread of variants, inflation developments and the effects of policy responses in the United States, the slowdown in economic growth in China amid concern over private debt problems, and geopolitical risks.

- It is extremely important for vaccines to be widely rolled out on a global basis and thereby reduce a risk of the emergence of new variants, contain infection, and prevent serious illness, so that people can resume economic activity without worry and the global economy can return to the stable growth path.

Prices

- The year-on-year rate of change in the consumer price index (CPI) has been at around 0 percent but is likely to increase moderately in positive territory in the short run, reflecting a rise in energy prices.

- Since producer prices have continued to increase at a historically high pace, mainly on the back of a rise in raw material prices, the underlying upward pressure on consumer prices also seems to have been increasing gradually.

- Despite the widening gap between the input prices DI and the output prices DI, the December 2021 *Tankan* indicates that there are signs of changes in firms' price-setting behavior, as seen in an upward revision in firms' inflation outlook.

- Inflation expectations, including medium- to long-term ones, have risen recently, and inflationary pressure is expected to strengthen. As the government encourages firms to increase wages, attention is paid to their rates of increase for next year onward.

- Achieving the price stability target by the end of fiscal 2023 is difficult given developments in the output gap and inflation expectations. However, attention is being paid to changes in firms' price-setting behavior and inflation expectations.

- In the next *Outlook for Economic Activity and Prices* (Outlook Report) to be released in January 2022, it is necessary to examine whether the current assessment that risks to prices are skewed to the downside will remain appropriate, considering, for example, the recent rises in inflation expectations and raw material costs.

II. Opinions on Monetary Policy

- Financial conditions have improved on the whole since last spring. With regard to those surrounding large firms, issuance conditions for CP and corporate bonds have been favorable, and precautionary demand for liquidity has subsided in the loan market. Regarding small and medium-sized firms, their financial positions have been on an improving trend on the whole, but weakness has remained in some segments, such as the face-to-face services industry.

- While issuance conditions for CP and corporate bonds have been favorable, weakness has remained in financial positions of firms in some industries and of small and medium-sized firms in particular. Given this situation, it is appropriate to revise the Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19) as follows: to complete additional purchases of CP and corporate bonds as scheduled and extend the Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19) by six months.

- Regarding the purchases of CP and corporate bonds under the Special Program, it is appropriate to complete additional purchases in consideration of the effects on market functioning and on the fund management by pension funds and life insurers in particular. With regard to the Special Operations to Facilitate Financing under the program, the Bank should lower the incentives for financial institutions to use the operations in light of the fact that many of their loans to small and medium-sized firms are the effectively interest-free and unsecured ones for which the credit risk is transferred to the government.

- Taking into account that financial conditions have improved from the situation in last spring, when the COVID-19 pandemic began, it can be considered that part of the Special Program has more or less fulfilled its intended role.

- Weakness has remained in financial positions of firms engaged in face-to-face services, many of which are small and medium-sized. It is therefore appropriate to extend the implementation period of the financing support for small and medium-sized firms under the Special Program.
- With regard to the Special Program, which is an emergency measure, the Bank should focus on the financing support for small and medium-sized firms that are concerned about their financial positions and decide the extension of its implementation period within this year, when such firms start making their business plans for the coming year.
- There are high uncertainties over the course of COVID-19, including the emergence of variants. At this MPM, the Bank should decide to extend the implementation period of the financing support and indicate its policy stance relatively early for the next fiscal year onward. That will give a sense of security to small and medium-sized firms as well as financial institutions.
- The Bank should lower the incentives for fund-provisioning against loans that financial institutions make on the back of government support ("government-supported loans") under the Special Operations to Facilitate Financing, partly because new applications already have been closed for the effectively interest-free and unsecured loans, which are one of the government-supported loans. The Bank should also make clear that the aim is to provide funds to financial institutions against the loans they make.
- The Bank provides funds against private debt pledged as collateral, which mainly consists of debt issued by large firms and housing loans, under the Special Operations to Facilitate Financing. There seems to be no problem with completing this fund-provisioning as scheduled.
- It is necessary to explain that the revision of the Special Program will not have negative effects on economic activity and prices and will be consistent with the Bank's policy with regard to expansion of the monetary base.
- The increase in the monetary base since last spring is the result of the Bank providing ample funds in response to the surge in liquidity demand due to the spread of COVID-19. Even if the monetary base decreases in the short run due to the revision of the Special Program proposed at this MPM, it will remain on an uptrend in the long run. Therefore, the revision will not be in contradiction with the inflation-overshooting commitment.

- The Special Program is a measure to respond to COVID-19, and it basically should be completed when the pandemic subsides. Even when the Bank completes the whole program, this will not mean in any sense a reduction in monetary accommodation under Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control; instead, it will simply mean that the Bank has finished with its responses to the pandemic.

- If the economic situation changes significantly due to the course of the pandemic, it may become necessary for the Bank to make policy responses that go beyond facilitating corporate financing. The Bank should clearly explain to the public that, if this becomes the case, it will not hesitate to take policy measures while cooperating with the government.

- Inflation in Japan is largely due to rises in prices of crude oil and commodities, and medium- to long-term inflation expectations have not been anchored to the price stability target of 2 percent. Adjustment of monetary easing measures at this juncture is premature, as it could hinder the economic recovery from the pandemic and bring about an economic downturn and a decline in prices.

- In the conduct of monetary policy, the Bank should strengthen its monetary easing stance with a view to improving the output gap and inflation expectations, and thereby achieve an economic recovery and the price stability target early.

- In order to achieve sustainable economic growth and the price stability target, it is necessary to have an economic structure where firms' new demand for funds is generated and the flow of funds increases. It is important to gather information on the initiatives taken by economic entities in realizing this structure.

III. Opinions from Government Representatives

Ministry of Finance

- The government recognizes that the extension of the Special Program shows the Bank's stance of continuing to do its utmost to facilitate smooth corporate financing.

- The government formulated new economic measures last month, and the supplementary budget to implement them is being deliberated in the Diet. In addition, the government is in the process of compiling the budget for fiscal 2022. It will also take appropriate actions based on the outline for tax reform formulated by the ruling parties on December 10.

- The government expects the Bank to conduct appropriate monetary policy based on developments in economic activity and prices as well as financial conditions while cooperating with the government.

Cabinet Office

- The government will do its utmost to support the economy and address downside risks to it, and will trigger a new form of capitalism. To this end, the economic measures were decided by the Cabinet.
- The economic measures are expected to support the economy and push up real GDP by about 5.6 percent. The government will swiftly implement them in order to put Japan's economy onto a growth path as soon as possible.
- The government considers that the Bank's decisions at this MPM regarding the Special Program are in line with the government's economic measures and that the Bank is making its utmost efforts to support financing, mainly of small and medium-sized firms. The government expects the Bank to continue to closely cooperate with the government and conduct appropriate monetary policy.