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March 29, 2022

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on March 17 and 18, 2022

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has picked up as a trend, although some weakness has been seen in part, mainly due to the impact of the novel coronavirus (COVID-19). A pick-up in private consumption has paused.
- Japan's economy, although expected to be affected by a rise in commodity prices, is likely to recover, with downward pressure stemming from COVID-19 on services consumption and the effects of supply-side constraints waning.
- Although attention needs to be paid to how households' and firms' sentiment will change due, for example, to a surge in prices of imported raw materials, Japan's economy is likely to pick up, particularly for services consumption, with the impact of COVID-19 waning.
- As was the case around 2008, Japan's terms of trade may deteriorate due to the recent rise in commodity prices. That said, in the current phase, the resilience of domestic demand seems to be higher than it was in 2008, given that the economy is on its way to recovery from a downturn caused by COVID-19 and that the so-called forced savings are expected to serve as a buffer against a decline in households' real income.
- There is a possibility that overseas economies will be pushed down due to central banks' policy responses to a rise in inflation brought about by the surge in commodity and grain prices.

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.

- It is significantly unclear how the situation surrounding Ukraine will evolve, and its impact on economic activity at home and abroad is highly uncertain. The risk that it will push down Japan's economy is of concern.
- Russia's invasion of Ukraine has caused uncertainties to become extremely high. A rise in commodity and food prices and the materialization of geopolitical risks may put strong downward pressure on the economy.
- In the wake of the economic sanctions imposed mainly on Russia, activities of Japanese firms that have made investment in the countries concerned have been constrained. Because the impact of the stagnant flow of goods and money takes time to materialize, attention needs to be paid to the possibility that there will be a further increase in constraints and burdens following the sanctions.
- Under the low interest rate environment, the once conservative institutions such as pension funds have shifted their investment from bonds to high-risk assets including stocks. If the situation surrounding Ukraine and the impact of rises in European and U.S. interest rates cause significant adjustments in prices of risk assets, this could substantially affect those institutions.
- Since it is difficult for labor supply to increase further for women and seniors, wages of the middle class are more likely to increase as the economy recovers.

Prices

- The year-on-year rate of change in the consumer price index (CPI), despite being affected by a reduction in mobile phone charges, has been at around 0.5 percent, reflecting price rises of energy and other items.
- Although it depends on developments in crude oil prices and policy responses by the government, it is possible that the year-on-year rate of change in the CPI will increase clearly in positive territory from April, due mainly to a rise in energy prices, and stay at around 2 percent for the time being.
- The underlying inflationary pressure is projected to increase, mainly on the back of improvement in the output gap and a rise in medium- to long-term inflation expectations.
- The year-on-year rate of change in the CPI is likely to be at around 2 percent in the first half of fiscal 2022, due mainly to a surge in commodity prices. From the second half, however,

attention needs to be paid to downside risks brought about by possible declines in commodity prices.

- It appears that firms have been passing on cost increases to a wider range of items. This seems to be because firms consider that they can now gain more acceptance by consumers of rises in selling prices than they did before, as there are circumstances where consumers are likely to find it reasonable for prices to rise, such as developments in competitors' price setting and price rises of energy and other items.
- As producer prices have continued to increase at a historically high pace, the underlying inflationary pressure in terms of the CPI seems to be gradually increasing as well. Attention is paid to whether the norm of refusing price rises, which seems to have been deeply entrenched in Japan, will diminish and whether improvement in the tolerance of price rises will be observed widely.
- Although retail prices have risen for energy-related items as well as food and other items, the pass-through of cost increases to retail prices overall has been limited thus far when considering the rise in producer prices. This indicates that the recovery in domestic demand has been insufficient and that it has remained difficult for firms to pass on cost increases to product prices under the current macroeconomic conditions.
- Given the household budget constraints and competitive environment for firms, it is unlikely that a surge in prices of imported raw materials will lead to a sustained rise in the overall CPI.
- Inflation brought about by a rise in import prices will only be temporary unless there is an increase in households' purchasing power. For sustained inflation, it is necessary to push up their purchasing power by increasing wages.
- Although changes continue to be observed in firms' price-setting behavior and inflation expectations, achieving the price stability target by the end of fiscal 2023 is difficult given developments in the output gap and inflation expectations.
- Raising firms' productivity is essential for sustained wage and price increases. Efforts by regional financial institutions are important in supporting the enhancement of firms' innovation through, for example, investment in human capital as well as in supporting the promotion of entry and exit of firms and their structural reforms through, for example, fostering startups.

II. Opinions on Monetary Policy

- Global financial and capital markets have been volatile in the wake of the situation surrounding Ukraine. That said, Japan's financial conditions have been accommodative on the whole, including for the CP and corporate bond markets.
- Unlike the United States and the United Kingdom, Japan is not in a situation where the inflation rate will likely exceed the price stability target of 2 percent in a continuous manner while accompanying rises in inflation expectations and wages. It is important for the Bank to continue with monetary easing to support the economic recovery from the pandemic.
- In Japan, there is a mixture of negative shocks to the economy and a virtuous cycle from a rise in corporate profits to increases in wages and business fixed investment. It is appropriate for the Bank to maintain monetary easing until underlying inflation reaches the price stability target in a stable and sustainable manner, so as to support the virtuous cycle.
- In addition to the impact of COVID-19, Russia's invasion of Ukraine has heightened uncertainties regarding future developments. In this situation, the Bank should continue with the current monetary easing and closely monitor developments in economic activity and prices.
- In the conduct of monetary policy, the effects that movements in commodity prices or exchange rates have on economic activity and prices, rather than the movements themselves, warrant consideration. It is therefore important that the Bank maintain the accommodative policy stance with the aim of achieving the price stability target in a stable and sustainable manner.
- Heightened geopolitical risks due to the situation surrounding Ukraine have caused price rises of energy and other items, and this will push down domestic demand while raising the CPI. Under these circumstances, it is necessary to improve labor market conditions and provide stronger support for wage increases, and therefore it is increasingly important that the Bank persistently continue with the current monetary easing.
- With the rises in commodity and other prices, the inflation rate may exceed 2 percent. However, if downward pressure on economic activity and prices increases, the economy may instead be in danger of falling into deflation again. If it becomes difficult to achieve the price stability target, the Bank should act nimbly and without hesitation.

- 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.
- Given recent changes in the external environment affecting Japan's economic activity and prices, it is important to consider monetary policy responses while assuming various possibilities.

III. Opinions from Government Representatives

Ministry of Finance

- The government has been working in cooperation with the international community in response to the invasion of Ukraine by Russia. While it is necessary to closely monitor its impact on Japan's economy, the government has compiled the emergency measures to respond to oil price hikes and been taking various steps.
- The budget for fiscal 2022 aims to realize a new form of capitalism through a virtuous cycle of growth and distribution, and the government has been making efforts to swiftly obtain the Diet's approval.
- The government expects the Bank to conduct appropriate monetary policy while taking the situation surrounding Ukraine and COVID-19 into account and cooperating with the government.

Cabinet Office

- The recently released second preliminary estimates of GDP for the October-December quarter of 2021 show that real GDP has almost recovered to the pre-pandemic level.
- On the other hand, due attention should be paid to the downside risks to the economy posed, for example, by the surge in raw material prices that mainly reflects the situation surrounding Ukraine. In order to minimize the impact on people's daily lives and business activities, the government will swiftly implement multilayered measures.
- The government expects the Bank to continue to conduct appropriate monetary policy while giving due consideration to developments in economic activity and prices as well as financial conditions and closely cooperating with the government.