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December 27, 2023

Bank of Japan

Summary of Opinions at the Monetary Policy Meeting^{1,2} on December 18 and 19, 2023

I. Opinions on Economic and Financial Developments

Economic Developments

- Japan's economy has recovered moderately and is likely to continue to do so. However, there remain extremely high uncertainties surrounding economic activity and prices.
- The domestic economy has been resilient on the whole. Although there are geopolitical risks and concern over slowdowns in overseas economies, private consumption seems to have continued on an uptrend, despite being affected by price rises, and corporate profits and business fixed investment plans have been solid.
- Regarding the outlook for private consumption, a key issue is whether wage hikes will continue and can support private consumption from the household income side.
- Since augmenting firms' management resources enables them to gain a higher degree of autonomy, attention is warranted on the growth of small and medium-sized firms with a relatively large-scale business operation, larger firms, and startups.
- If firms adopt stronger cost-cutting measures in response to lower capacity utilization due to the yen's appreciation and slowdowns in overseas economies, they could have less of an appetite for wage hikes and investment. Therefore, close attention is required on firms' profit plans and their business policies, including those of small and medium-sized firms.

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

- The likelihood of realizing the outlook that underlying inflation will increase gradually toward achieving the price stability target has been gradually rising.
- While the effects of a pass-through of the past rise in import prices to consumer prices have gradually waned, the year-on-year rate of increase in services prices has been accelerating moderately as a trend, partly on the back of a rise in personnel expenses.
- As the year-on-year rates of increase in the consumer price indexes (CPIs) have declined overseas, a slowdown in Japan's inflation rate, particularly in terms of goods prices, has also gradually become evident. Given this, there is a growing possibility that the rate of increase in Japan's CPI will decelerate for a while.
- The *Tankan* (Short-Term Economic Survey of Enterprises in Japan) and other sources suggest that, with a moderate uptrend in medium- to long-term inflation expectations and successful support from the government, changes have been seen in small and medium-sized firms' price-setting stance.
- To achieve the price stability target, it is important that wages continue to be raised for the next fiscal year and beyond. Therefore, close monitoring is warranted on developments in wage hikes, especially those by small and medium-sized firms.
- In examining progress toward intensification of the virtuous cycle between wages and prices, attention is warranted on whether higher personnel expenses due to wage hikes will be passed on to selling prices in the services industry, where it is more difficult relative to the manufacturing industry to absorb cost increases by raising productivity.
- Many firms have reported that it remains difficult to pass on higher wages to services prices. In addition, statistics show that only hotel charges have seen a notable increase in services prices, and the contribution of the rise in services prices to the rise in the overall CPI has been only around 1 percent.
- Attention needs to be paid to whether or not systems and practices concerning price setting have hindered the intensification of the virtuous cycle between wages and prices.
- As the idea that cost increases due to wage hikes should be absorbed by firms' efforts has been entrenched, a pass-through of wage hikes to selling prices requires improvement in customer satisfaction. To achieve this, human resource development as well as investment in human capital and research and development (R&D) are important.

- The momentum in wage hikes is stronger than last year. Moreover, moves to pass on higher personnel expenses to prices have spread and the year-on-year rate of increase in services prices, which are sticky, has continued to be high. The background to these developments is changes in Japanese firms' wage- and price-setting behavior.
- Although the impact of the rise in import prices is expected to wane, it has continuously fed through to the virtuous cycle between wages and prices. Moreover, a changing social atmosphere is likely to lead relevant entities to take a joint stance toward wage hikes. Given these factors, it is highly possible that the wage growth to be agreed in next year's wage negotiations will exceed that agreed this year. It seems that achievement of the price stability target is coming in sight, and the second half of fiscal 2023 is an important period for finally determining whether the target will be achieved.

II. Opinions on Monetary Policy

- Sustainable and stable achievement of the price stability target is not yet envisaged with sufficient certainty at this point, and thus the Bank needs to patiently continue with monetary easing under yield curve control.
- In determining whether to terminate the negative interest rate policy and the yield curve control framework, a virtuous cycle between wages and prices needs to be confirmed and, on this basis, sustainable and stable achievement of the 2 percent target needs to come in sight.
- To achieve the 2 percent target through the virtuous cycle between wages and prices, the growth momentum in nominal wages needs to strengthen further. It is thus important for the Bank to support the momentum in wage hikes through continuation of monetary easing.
- In consideration of the situation where strong upward pressure on prices has been subsiding, it is important to determine wage and price developments under the current yield curve control.
- Given that the wage growth rate has not caught up with the inflation rate to date, even if next spring's wage hikes are considerably higher than expected, the risk that this will cause underlying inflation to significantly exceed 2 percent is small. The Bank is currently not in a situation where it would fall behind the curve if it did not rush to raise policy interest rates. It would not be too late even if the Bank makes a decision after it sees developments in labor-management wage negotiations next spring.

- Increasing the flexibility in the conduct of yield curve control at the previous MPM has lowered the likelihood of distortions on the yield curve. Therefore, unless underlying inflation strengthens to an excessive degree, the Bank will have sufficient leeway to determine whether the 2 percent target will be achieved through a virtuous cycle between wages and prices.
- Buds of change in the structure of the economy have appeared, driven by labor shortages. It is appropriate that the Bank focus on encouraging these changes so as not to lose this golden opportunity and continue with the current monetary easing for the time being.
- While the risk of prices becoming excessively higher than expected and the Bank needing to rapidly tighten monetary policy is small, the cost incurred if this risk materializes would be significant.
- With the likelihood of achieving the price stability target of 2 percent in a sustainable and stable manner rising further, the timing of normalization of monetary policy is getting closer. While it is undesirable to make hasty decisions, it is "better to be rough and ready than slow and elaborate," as the saying goes. To avoid the risk of high prices damaging the underlying trend in consumption and undermining the achievement of the price stability target, the Bank should not miss an opportunity in normalizing monetary policy.
- Looking ahead toward the future exit from the current monetary policy, it is necessary to examine the positive effects and side effects of yield curve control and of the negative interest rate policy, and also consider their treatment.
- For the time being, close attention should be paid to developments in domestic demand, such as private consumption. However, given the improving trend in economic activity and prices, the treatment of yield curve control and asset purchases other than Japanese government bond (JGB) purchases should be considered thereafter, taking account of, for example, their impact on the market.
- The condition of "as long as it is necessary for maintaining the price stability target in a stable manner" in the Bank's forward guidance implies that it will allow some modifications to Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control if achievement of the target is likely to be in sight after implementing such modifications. The forward guidance does not indicate the path of the policy interest rates following the achievement of the condition.

- It is important for the Bank to continue to deepen discussions on issues such as the timing of the exit from the current monetary policy and the appropriate pace of raising policy interest rates thereafter, while giving consideration to the relationship with wage and price developments going forward.
- The Bank holds a large amount of JGBs, bearing much of the market's interest rate risk. Therefore, from the perspective of maintaining confidence in its ability to conduct monetary policy in the exit phase, it is important that the Bank provide communication on central banks' balance sheets and the mechanism of changes in their profits.

III. Opinions from Government Representatives

Ministry of Finance

- The supplementary budget for implementing comprehensive economic measures was approved by the Diet recently. The government is currently in the process of finalizing the budget for fiscal 2024.
- The outline for tax reform for fiscal 2024 was formulated by the ruling parties on December 14, and the government will take appropriate actions based on it.
- The government expects the Bank to conduct appropriate monetary policy toward achieving the price stability target in a sustainable and stable manner while closely cooperating with the government.

Cabinet Office

- Through the comprehensive economic measures, the government will protect people's daily lives from high prices and will sustain and expand the trend of wage hikes. It will also raise Japan's potential growth rate by enhancing the supply capacity of its economy, thus leading to sustained wage hikes. The government will explore frontiers and promote efforts such as social implementation of new technologies, thereby structuring an economy that can grow in a sustainable manner even with a declining population.
- The government expects the Bank to conduct appropriate monetary policy toward achieving the price stability target of 2 percent in a sustainable and stable manner, accompanied by wage increases, taking account of developments in economic activity and prices as well as financial conditions.