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December 28, 2022

Bank of Japan

## Summary of Opinions at the Monetary Policy Meeting<sup>1,2</sup> on December 19 and 20, 2022

### I. Opinions on Economic and Financial Developments

#### *Economic Developments*

- Japan's economy has picked up. It is likely to recover, with the impact of the novel coronavirus (COVID-19) and supply-side constraints waning, although it is expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies.
- The pace of recovery in overseas economies has slowed. Their growth is expected to slow, reflecting the situation surrounding Ukraine and the impact of the COVID-19 resurgence in China, in addition to inflationary pressure exerted on a global basis and policy interest rate hikes by overseas central banks.
- Although clearer signs of slowdowns have been seen in overseas economies, Japan's economy has continued to pick up, partly supported by increases in business fixed investment and private consumption, which have been constrained due to the pandemic.
- Japan's economy is expected to grow at a pace above its potential growth rate due to factors such as stronger momentum for wage hikes as well as a boost in "investment in people" and investment in digital transformation. Therefore, the course of wage revisions for spring 2023 and the trend in various investments warrant close monitoring.

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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.

- For sustainable economic growth in Japan, it is necessary that productivity of small and medium-sized firms improve through, for example, measures to support them in enhancing their export competitiveness.
- There is a certain degree of possibility that relatively high wage increases will be achieved in Japan, given factors such as a quite positive stance toward wage hikes among the government, labor, and management, generally favorable corporate profits, and the relationship between labor and management, where there is a strong tendency to support each other.
- There have been moves among labor unions to demand wage increases given the rise in prices, and a positive stance has been observed among firms to respond to such demand amid a tightening of labor market conditions. These developments could lead to pushing up prices in a sustainable manner.
- Since the sustainability of wage hikes depends on firms' growth potential, supply-side reforms to strengthen their "earning power" are an important factor in achieving the price stability target of 2 percent. The inflation rate for general services warrants attention as a barometer of such reforms.
- Developments in overseas economic activity and prices have been surrounded by significant risks, including developments in the U.S. inflation rate in reflection of continued high services prices and wage growth and the impact of the COVID-19 resurgence in China.

### *Prices*

- The year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is likely to increase toward the end of this year and then decelerate toward the middle of fiscal 2023.
- Commodity prices, including for crude oil, peaked out and have turned to a decline. The year-on-year rate of increase in the import price index decelerated clearly for November.
- The year-on-year rate of increase in the CPI is expected to decelerate after the turn of the year, considering, for example, a waning of upward pressure from import prices going forward and the government's support measures regarding electricity charges.
- While both actual prices and inflation expectations have risen, the recent rise in services prices is largely due to the impact of high raw material costs, and there is still a long way to go to achieve the price stability target of 2 percent in a sustainable and stable manner.

- CPI inflation is expected to fall below 2 percent after upward pressure of costs peaks out. For the inflation rate to accelerate again to 2 percent and stay at this level, it is necessary that nominal wages increase sufficiently and inflation rise in items for which consumer prices are sticky, especially services.
- An increasing number of firms have passed on cost increases to their selling prices. This may contribute to strengthening the momentum of underlying inflation or lead to a virtuous cycle through an increase in corporate profits.
- Inflation in prices of not only goods but also services has gradually risen, and the trimmed mean and weighted median of the year-on-year rate of change in the CPI have seen a further rise. This suggests a possibility that the momentum of inflation has started to strengthen.
- Consumer prices in Japan are approaching the state seen before the deflationary period, as suggested by the price change distribution for CPI items and by the level of the CPI excluding fresh food and energy. This could be considered a sign of progress toward achieving a situation where Japan's economy will not return to deflation.
- In assessing price developments, it is necessary to examine underlying inflation by looking at various related indicators and take into account the effects of the government's comprehensive economic measures on consumer prices.

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

- The Bank should continue with Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, aiming to achieve the price stability target, as long as it is necessary for maintaining that target in a stable manner.
- Japan's economy is currently in a critical phase for achieving the price stability target of 2 percent in a sustainable and stable manner, and continuing with monetary easing is necessary.
- Signs of a virtuous cycle have started to be seen, as evidenced by the overall high levels of corporate profits and moves to increase wages amid tight labor market conditions. However, the price stability target is not considered to have been achieved, and therefore it is appropriate for the Bank to maintain monetary easing with respect to the conduct of monetary policy for the time being.
- Japan's economy is currently in a critical phase with regard to whether it can achieve a virtuous cycle between wages and prices. It is therefore appropriate for the Bank to continue

with monetary easing and thereby firmly support the economy and realize a favorable environment for firms to raise wages.

- Financial conditions in Japan have been accommodative on the whole. However, the functioning of bond markets has deteriorated, and if this situation persists, it could have a negative impact on financial conditions such as issuance conditions for corporate bonds and hamper the transmission of monetary easing effects.
- Amid deterioration in the functioning of bond markets, investor sentiment has become cautious, and spreads on corporate bond yields have widened. Although issuance conditions for corporate bonds seem to have remained favorable when taking the amount and number of issuances into consideration, the current situation warrants attention.
- While stabilizing long-term yields at low levels is necessary in order for Japan's economy to see sustainable growth, a possible negative impact on market functioning is of concern. It is therefore appropriate for the Bank to continue with yield curve control while expanding the range of 10-year Japanese government bond (JGB) yield fluctuations from the target level.
- The expansion of the range of 10-year JGB yield fluctuations from the target level is not intended to change the direction of monetary easing. It is a policy measure to make the current monetary easing -- which is conducted with the aim of achieving the price stability target of 2 percent -- more sustainable amid global inflation through improvement in the functioning of bond markets.
- It is necessary to expand the range of 10-year JGB yield fluctuations from the target level so as to address the deterioration in market functioning. Even in that case, the strong easing effects exerted through lower real interest rates will continue, partly due to higher inflation expectations.
- Looking at the JGB yield curve, there is a distortion in the price formation of 10-year bonds. In view of avoiding its negative impact, an expansion in the range of 10-year JGB yield fluctuations from the target level is necessary. However, this is not a policy change toward an exit from monetary easing, and the current accommodative policy stance should be maintained through JGB purchases.
- The expansion of the range of 10-year JGB yield fluctuations from the target level will contribute to enhancing the sustainability of yield curve control. Moreover, with a view to stabilizing the entire yield curve at a low level, increasing the purchase amount of JGBs for

all maturities and, depending on the situation, making nimble additional purchases will lead to enhancing the sustainability of monetary easing.

- The modification of the conduct of yield curve control will contribute to improving market functioning. It is important to humbly monitor where and how markets will settle and to what extent market functioning will improve.
- It is important for the Bank to keep the level of interest rates low so as to encourage the reforms in economic and wage structures that are necessary for sustained wage increases. This requires enhancing the sustainability of yield curve control.
- Since fund management and financing have continued to be based on the assumption that interest rates will remain low for a long period, in the phase of an exit from the current monetary policy, it will be necessary to examine where the risks associated with a rise in interest rates lie and whether market participants are well prepared.
- Although it is appropriate to continue with monetary easing at this point, it is necessary to examine this at some point in future and assess the balance between positive effects and side effects.
- There has been an argument that the price stability target of 2 percent needs to be reviewed and examined, including the validity of the numerical target value. However, revision of that value is not appropriate since it could make the target ambiguous and the monetary policy response inadequate.

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

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

- The government considers that the matters discussed today are aimed at conducting monetary easing in a more sustainable manner.
- The government has recently formulated comprehensive economic measures and obtained the Diet's approval of the supplementary budget to implement them. The government is currently in the process of finalizing the budget for fiscal 2023.
- The outline for tax reform for fiscal 2023 was formulated by the ruling parties on December 16, and the government will take appropriate actions based on it.

- The government expects the Bank to continue to work toward achieving the price stability target in a sustainable and stable manner while cooperating with the government.

### *Cabinet Office*

- The government will thoroughly manage progress of the comprehensive economic measures that have been formulated recently and of the supplementary budget, and implement them swiftly and steadily.
- The government considers that the matters discussed at this MPM are aimed at conducting monetary easing in a more sustainable manner with a view to achieving the price stability target. It deems it important for the Bank to carefully explain its policy intention to the public.
- The government expects the Bank to continue to conduct appropriate monetary policy, based on due consideration of developments in economic activity and prices as well as financial conditions, while closely cooperating with the government.