Notes on Financial Markets Vol.259

Summary of Opinions at July MPM—Variety of reasons

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Introduction

The BOJ decided to maintain its policy rate at 0.5% at July MPM. Members expressed a variety of reasons for maintaining the fundamental strategy of policy normalization.

Assessment of economy

First line of comment confirmed the central view that the growth rate would re-accelerate after its deceleration due to the effects of trade policies by major economies. Next two lines of comment expressed the constructive views. One of them appreciated the reduction in uncertainty of the outlook by the agreement of the US tariffs. The other suggested that the impacts had been contained in some specific sectors.

In contrast, the other two lines of comments expressed the cautious views. First of them warned the negative impacts after diminishing front-loading exports. The other raised the uncertainty about the impacts on the US economy both in terms of inflation and consumption.

Following several lines of comments discussed the global implications. First of them suggested the complacency about the impacts by the US tariffs. The second comment argued that the phase of economy may have changed after the agreement of the US tariffs and the legislative approval of tax reduction in the US. The last comment referred to the upside risks of economy and inflation due to the expansionary economic policies in major and emerging countries.

Assessment of prices

First two lines of comments confirmed the central scenario. First of them expected re-acceleration of underlying inflation as the economic growth rate recovers after its stagnation. The other reiterated the view that underlying inflation would convergence to the target in the later phase of the outlook, while it remained below 2%.

Next line of comment suggested the mixed implications of extreme heat this summer. Specifically, it would cause upward pressure of food prices due to supply constraint. On the other hand, reduction in demands of goods and services as well as negative impacts on productivity would be possible.

Looking forward, a number of comments suggested the upside risks.

Two line of comments suggested the structural changes of prices. One of them raised the possibility that the perception of inflation would not change even if the rate of rise in rice price diminishes. It also argued that it should be watched carefully the anchoring underlying inflation at 2% under downside risks of headline inflation.

The other raised the possibility that the effects of temporary rise in prices may have become stronger than the effects of drop in prices due to reduction in import prices. It further argued that the asymmetry may have backgrounds including deteriorating labor shortages, changing behaviors of firms and households against prices and wages, and rise in inflation expectation.

Furthermore, last two lines of comments raised the near-term upside risks. First of them insisted that the judgment of achieving 2% target in the earlier phase of the outlook would be possible in light of the agreement of the US tariffs, the maintenance of positive behavior of firms against wages and prices and elevated rate of actual inflation. It also argued that the risk of higher inflation beyond 2% should be concerned. The other comment raised the risk of acceleration of inflation due to prospective fiscal policy in Japan.

Decision on policy rate

First line of comment confirmed the central view of policy normalization as far as the economy and prices would evolve in line with the outlook, while it pointed out the needs to make judgment without any prejudice.

Following two lines of comments insisted the remaining uncertainties about domestic and overseas impacts of the US tariffs as well as the reactions by the FRB and foreign exchange markets. As a result, they suggested to maintain the current policy stance for now.

In contrast, the other of line comment expressed the optimistic view that the BOJ could exit from “wait-and-see” stance toward the end of this year if the US economy shows stronger resiliency than expected.

Next two lines of comments raised the risk of excessive conservatism of monetary policy. One of them discussed the risk of overvaluation of stock prices with reference to the current lower than neutral policy rate. The other suggested the appropriateness of gradual rise of policy rate for our economy from the viewpoint of risk management.

Following set of comments discussed the issues of inflation expectation and underlying inflation. Regarding the inflation expectation, a line of comment confirmed the view that both actual and expected inflation continued to rise with improvement of corporate profits and wage rises. It also insisted that rises in food and energy prices had larger impacts on inflation expectation as the households could easily identify the price changes.

Interestingly, two lines of comments suggested the modification of strategy. The first suggested that the BOJ should pay more attention to actual inflation when underlying inflation was closer to the target. The other suggested that the focus of dialogue should be shifted to a set of indicators including actual inflation and its forecast, GDP gap and inflation expectation. In contrast, a line of comment argued that underlying inflation remained important for monetary policy despite its challenge of estimation.

All in all, the other line of comment suggested that the communication with view of achieving the target would be relevant, considering the rise in underlying inflation and the growing importance of the upside risk of inflation.

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