Not to be released until 8:50 a.m. Japan Standard Time on Friday, February 21, 2014.

February 21, 2014

Bank of Japan

Minutes of the Monetary Policy Meeting

on January 21 and 22, 2014

(English translation prepared by the Bank's staff based on the Japanese original)

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Tuesday, January 21, 2014, from 2:00 p.m. to 4:36 p.m., and on Wednesday, January 22, from 9:00 a.m. to 12:15 p.m.[1]

Policy Board Members Present

Mr. H. Kuroda, Chairman, Governor of the Bank of Japan

Mr. K. Iwata, Deputy Governor of the Bank of Japan

Mr. H. Nakaso, Deputy Governor of the Bank of Japan

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Mr. T. Sato

Mr. T. Kiuchi

Government Representatives Present

Mr. Y. Furukawa, Senior Vice Minister of Finance, Ministry of Finance[2]

Mr. M. Asakawa, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

Mr. Y. Nishimura, Senior Vice Minister, Cabinet Office[2]

Mr. K. Umetani, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director (Assistant Governor)

Mr. S. Uchida, Director-General, Monetary Affairs Department

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1 The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on February 17 and 18, 2014 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

2 Messrs. Y. Furukawa and Y. Nishimura were present on January 22.

3 Messrs. M. Asakawa and K. Umetani were present on January 21.

Mr. K. Masaki, Head of Policy Planning Division, Monetary Affairs Department

Mr. H. Yamaoka, Director-General, Financial Markets Department

Mr. E. Maeda, Director-General, Research and Statistics Department

Mr. S. Kameda, Head of Economic Research Division, Research and Statistics Department

Mr. H. Toyama, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. N. Yoshioka, Director-General, Secretariat of the Policy Board

Mr. N. Fukunaga, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. T. Kawamoto, Senior Economist, Monetary Affairs Department

Mr. T. Sugo, Senior Economist, Monetary Affairs Department

I. Summary of Staff Reports on Economic and Financial Developments[4]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on December 19 and 20, 2013, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, the amount outstanding of the monetary base had been in the range of 196-205 trillion yen.

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been at low levels. The uncollateralized overnight call rate had been at a level below 0.1 percent. General collateral (GC) repo rates, although having temporarily weakened somewhat in late December to early January, had recently been at around 0.1 percent on the whole. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been below the 0.1 percent level for all maturities. Rates on longer-term interbank instruments had been flat.

Long-term interest rates in Japan had risen slightly at a time when Japanese stock prices and U.S. long-term interest rates rose, but thereafter dropped somewhat as Japanese stock prices fell, and had recently been in the range of 0.65-0.70 percent. The Nikkei 225 Stock Average had risen temporarily with the depreciation of the yen on the back of the rise in U.S. stock prices, but declined thereafter, mainly in response to the appreciation of the yen, and had been more or less unchanged throughout the intermeeting period. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, although some corporate bond spreads had been wide. In the foreign exchange market, the yen had depreciated somewhat against the U.S. dollar, coupled with the rise in Japanese stock prices in a situation where U.S. economic indicators were stronger than market expectations. The yen then appreciated against the U.S. dollar, mainly in response to U.S. employment statistics that turned out to be weaker than market expectations. The U.S. dollar/yen rate had recently been in the range of 104-105 yen.

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4 Reports were made based on information available at the time of the meeting.

5 The guideline was as follows:

The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

C. Overseas Economic and Financial Developments

Overseas economies -- mainly advanced economies -- were starting to recover, although a lackluster performance was still seen in part.

The U.S. economy had been on a moderate recovery that had gradually become widespread. Housing investment continued to generally pick up, although the pace had become somewhat moderate. Private consumption had been firm as asset prices continued to rise and the employment situation remained on its improving trend. Exports also continued to increase. Reflecting these developments in demand, business sentiment continued to improve, and the pace of increase in production had risen somewhat. Moreover, business fixed investment was starting to pick up. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less food and energy, or the core CPI, had been more or less flat. In this situation, the year-on-year rate of increase in the CPI for all items had climbed, mainly as a result of the narrowing of the year-on-year rate of decline in energy prices.

The European economy had been picking up. Private consumption had been picking up moderately, with consumer sentiment continuing to improve, although the employment and income situation remained severe. Business fixed investment had bottomed out. In addition, exports were heading toward a pick-up. Reflecting these developments in demand, production was starting to pick up. As for prices, slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, and the year-on-year rates of increase in both the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food and the HICP for all items had been on a moderate declining trend. Meanwhile, economic activity in the United Kingdom was recovering, particularly in domestic demand.

With regard to Asia, the Chinese economy continued to see stable growth on the back of firm domestic demand. Stable growth in private consumption continued against the background of a favorable employment and income situation, although effects of the government's frugality campaign continued to be observed in some areas. Fixed asset investment also remained firm. Moreover, exports had been picking up, particularly those to Europe and the United States. With these developments in demand, production had continued to mark relatively high growth, particularly in the machinery industry, including motor vehicles. As for prices, the year-on-year rate of increase in the CPI had been somewhat low as a trend. Regarding the NIEs and the ASEAN countries, while economic developments in the NIEs were picking up somewhat, growth momentum in the ASEAN countries remained weak. As for prices, the year-on-year rates of increase in the CPI generally continued to be at somewhat low levels, although there were differences by country and region. In India, the economy remained in a state of deceleration, particularly in domestic demand.

In a situation where global financial markets had been stable on the whole, even after the Federal Reserve made its decision to begin reducing the pace of its asset purchases, investors resumed their risk-taking stance -- particularly in the markets of advanced economies -- on the back of expectations for recovery in economic activity. Meanwhile, in emerging markets, foreign exchange rates as well as stock and bond prices had generally been weakening. International commodity prices continued to be weak from a relatively longer-term perspective in a situation where recovery in emerging economies lacked momentum, and had been weakening on the whole.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had generally been picking up. Real exports had fallen marginally in the July-September quarter of 2013 on a quarter-on-quarter basis, but rose again in the October-November period relative to that quarter. Exports were expected to increase moderately, mainly against the background of the recovery in overseas economies.

Public investment continued to increase. It was expected to trend upward for the time being and then become more or less flat at a high level.

Business fixed investment had been picking up as corporate profits had improved. The aggregate supply of capital goods -- a coincident indicator of machinery investment -- on a basis excluding transport equipment was more or less flat in the July-September quarter of 2013, but rose noticeably in the October-November period compared with that quarter. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- continued to increase markedly in the July-September quarter on a quarter-on-quarter basis and in the October-November period relative to that quarter. Business fixed investment was projected to follow a moderate increasing trend as corporate profits continued to improve.

As for the employment and income situation, supply and demand conditions in the labor market continued to improve steadily, albeit at a moderate pace, and employee income had also shown a pick-up.

Private consumption remained resilient, with improvement in the employment and income situation, and a front-loaded increase in demand prior to the consumption tax hike had also been observed. As for durable consumer goods, the number of new passenger-car registrations had turned upward since around summer 2013 with the introduction of new models, and had recently shown considerably strong movements. In addition, sales of household electrical appliances had been steady, albeit with fluctuations. It was likely that such movements in durable consumer goods had been reflecting to some extent the front-loaded increase in demand prior to the consumption tax hike, including its ripple effects of an increase in housing investment. Meanwhile, indicators related to consumer confidence -- which had continued on an improving trend, albeit with fluctuations, after rising at a rapid pace since the start of 2013 -- had been relatively weak since October. Private consumption was expected to remain resilient as a trend, supported mainly by improvement in the employment and income situation, albeit with some fluctuations caused by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike.

Housing investment continued to increase, and the effects of the front-loaded increase in demand prior to the consumption tax hike had become clear. It was expected to remain resilient as a trend, albeit with some fluctuations caused by the hike.

Reflecting these developments in demand both at home and abroad, industrial production had been increasing moderately. It was expected to continue on such a trend, mainly reflecting developments in demand at home and abroad, albeit with some fluctuations caused by the effects of the consumption tax hike. Judging from interviews with firms and other relevant information, production for the January-March quarter of 2014 was projected to continue increasing in a wide range of industries, with the ongoing moderate recovery in demand both at home and abroad.

As for prices, domestic corporate goods prices were rising moderately relative to three months earlier, mainly against the backdrop of movements in international commodity prices and foreign exchange rates. The year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent. With regard to the outlook, excluding the direct effects of the consumption tax hike, domestic corporate goods prices were expected to continue rising moderately for the time being, and the year-on-year rate of increase in the CPI was likely to be around 1¼ percent for some time. Meanwhile, inflation expectations appeared to be rising on the whole, considering the results of various surveys.

2. Financial environment

Financial conditions were accommodative.

The monetary base had increased significantly as asset purchases by the Bank had progressed, and the year-on-year rate of growth had been at around 45 percent.

Firms' funding costs had been hovering at low levels. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. Firms' credit demand had been increasing moderately, mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been at around 2.5 percent. The amount outstanding of CP and corporate bonds had been more or less around the year-ago level. Firms retained their recovered financial positions. Meanwhile, the year-on-year rate of growth in the money stock had been in the range of 4.0-4.5 percent, mainly due to the increase in bank lending.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments

A. Economic Developments

Members shared the recognition that global financial markets had been stable on the whole, even after the Federal Reserve made its decision to begin reducing the pace of its asset purchases. Some members said that emerging markets had been somewhat nervous, especially in economies with unstable political situations and those facing structural problems such as current account deficits. Based on this discussion, members concurred that it was necessary to continue to carefully monitor developments in global financial markets, including emerging markets.

Members concurred that overseas economies -- mainly advanced economies -- were starting to recover, although a lackluster performance was still seen in part. As for the outlook, they shared the recognition that overseas economies -- mainly advanced economies -- would recover moderately. One member said that the U.S. economy was likely to be the driving force of overseas economies, noting that the forecast for global growth -- particularly for the U.S. economy -- presented in the *World Economic Outlook* released in January 2014 by the International Monetary Fund (IMF) was revised upward from the one presented in October 2013.

With regard to developments in overseas economies by region, members agreed that the U.S. economy had been on a moderate recovery that had gradually become widespread. Many members pointed out that, although U.S. employment statistics had become somewhat weak due in part to adverse weather conditions, retail sales had been steady in the household sector and some indicators suggested improvements in production and business fixed investment in the corporate sector. As for the outlook, members shared the view that the pace of economic recovery would gradually rise, mainly as accommodative financial conditions would be maintained and the fiscal drag would gradually fade. A few members said that the growth rate of the U.S. economy would gradually accelerate as consumption and housing investment would likely remain firm, reflecting the progress in adjustments in household debt, and as corporate activity -- mainly in manufacturing -- would likely head toward a recovery on the back of improvement in expectations for economic growth. Meanwhile, one member commented that, while the aggressive monetary easing by the Federal Reserve underpinned the U.S. economic recovery, there was a risk that the formation of asset prices would be distorted.

Members shared the recognition that economic activity in the euro area had been picking up. Some members expressed the view that, in a situation where business and household sentiment continued to improve, private consumption had been improving, albeit moderately, and exports were heading toward a pick-up. As for the outlook, members concurred that the economy was likely to continue picking up as domestic demand was expected to do so as well, and as exports would likely recover moderately. A few members, however, pointed out that attention should be paid to the possibility that pressures to adjust wages would remain in a situation where there was slack in supply and demand conditions in the labor market, and that the disinflationary trend would become prolonged.

Members agreed that the Chinese economy continued to see stable growth on the back of firm domestic demand. As for the outlook, most members expressed the view that the economy would maintain stable growth at around the current pace as authorities would likely continue to pay consideration to economic activity while progressing with structural reforms, and on the back of expectations that external demand would continue improving moderately. On the other hand, one member noted that the growth rate could decline moderately, due to the government's stance of restraining infrastructure investment and to corrections to accommodative financial conditions.

Regarding the NIEs and the ASEAN countries, members concurred that, while economic developments in the NIEs were picking up, growth momentum in the ASEAN countries continued to be weak. Many members pointed out that exports from South Korea and Taiwan showed signs of picking up due to the improvement in advanced economies. As for the outlook, members shared the recognition that the pace of economic growth in the NIEs and the ASEAN countries would likely remain relatively slow for the time being, but thereafter would rise again as growth in advanced economies was expected to gain momentum over time.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy.

With regard to economic activity, members shared the view that the economy continued to recover moderately, and a front-loaded increase in demand prior to the consumption tax hike had recently been observed. They agreed that a virtuous cycle among production, income, and spending continued to operate, as evidenced by the fact that (1) in the household sector, private consumption and housing investment remained firm as the employment and income situation had been improving; and (2) in the corporate sector, business fixed investment had been picking up as corporate profits had improved. Some members said that it was necessary to carefully examine the extent of the front-loaded increase in demand while acknowledging the difficulty of capturing it on a real-time basis. As for the outlook for the economy, members shared the view that, while it would be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike, the economy was likely to continue its moderate recovery as a trend as the virtuous cycle among production, income, and spending would continue to operate. A few members pointed out that, in assessing the economic situation after the consumption tax hike, it was important to gauge the underlying trends while paying close attention to developments in exports and business fixed investment, as these were less susceptible to such hikes. On this point, one member expressed the view that developments in exports -- together with an increase in business fixed investment -- would offset the decline in private consumption following the consumption tax hike, and thereby underpin perceived economic conditions.

Members shared the recognition that, as overseas economies -- mainly advanced economies -- were starting to recover, Japan's exports had generally been picking up, albeit with fluctuations, although the weak momentum remained a matter of concern. Some members expressed the view that the lack of momentum in exports, despite the earlier depreciation of the yen, reflected developments in overseas economies, such as the relatively weak business fixed investment in these economies. On this point, one member noted that signs of recovery in business fixed investment in overseas economies had been observed, pointing out that machinery orders from abroad -- a leading indicator of such investment -- had been picking up recently, albeit with fluctuations. One member pointed out that, in some sectors, the lack of momentum in exports was partly attributable to low spare capacity for exports, reflecting the strong momentum in domestic demand. As for the outlook, members agreed that exports were likely to increase moderately, mainly against the background of the recovery in overseas economies. One member noted that the pick-up in the NIEs would underpin developments in Japan's exports.

Members concurred that business fixed investment had been picking up as corporate profits had improved, and was projected to follow a moderate increasing trend. Many members noted that the aggregate supply of capital goods and machinery orders had been rising noticeably. One member expressed the view that, while firms' transfer of production to overseas could weigh on domestic business fixed investment in manufacturing and on exports, an increase in firms' profits earned overseas could support Japan's economic growth through an improvement in the balance of income. Meanwhile, one member pointed out that machinery orders from the automobile industry had been flat for about a year, which suggested that business fixed investment lacked momentum.

As for the employment and income situation, members shared the recognition that supply and demand conditions in the labor market continued to improve steadily, albeit at a moderate pace, and employee income had also shown a pick-up. They agreed that a pick-up in employee income was likely to gradually become clearer as the recovery in economic activity and business performance became evident. Some members expressed the intent to pay close attention to the outcome of wage negotiations to be held this spring. Some members expressed the view that positive effects on employee income would spread not only to large firms but also to small ones, considering the improvements in (1) supply and demand conditions in the labor market, evidenced particularly by the fact that the active job openings-to-applicants ratio had reached 1.00; and (2) corporate profits, even those of small firms. In response to this view, one member pointed to the possibility that the rate of wage increases might turn out to be lower than the inflation rate excluding the effects of the consumption tax hike.

Members shared the recognition that private consumption remained resilient, with improvement in the employment and income situation, and a front-loaded increase in demand prior to the consumption tax hike had also been observed. They shared the view that it was likely that the movements in consumption of durable consumer goods such as motor vehicles had been reflecting to some extent the front-loaded increase in demand prior to the consumption tax hike, in addition to the improvement in the employment and income situation evidenced by the increase in winter bonus payments. One member mentioned that, judging from interviews with firms, developments in private consumption in late December to early January had been firm. A different member pointed out that, while consumption of durable consumer goods had been increasing, due in part to the front-loaded increase in demand, there had been relatively weak developments in some services consumption. Members concurred that private consumption was likely to remain resilient as a trend, supported mainly by improvement in the employment and income situation, albeit with some fluctuations caused by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike. A few members expressed the view that private consumption was likely to remain resilient considering that the number of employees would increase and a pick-up in employment income would become evident. One member -- while noting the relatively weak developments in consumer confidence since October 2013 -- said that this might be attributable to consumers' awareness of the consumption tax hike, and future developments warranted attention.

Members agreed that industrial production had been increasing moderately, reflecting these developments in demand both at home and abroad, and that this was likely to continue as a trend.

Regarding prices, members shared the view that the year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent and the rate of increase, excluding the direct effects of the consumption tax hike, was likely to be around 1¼ percent for some time. Many members said that price rises had been observed not only in energy-related goods but also across a wide range of items, as evidenced by the fact that the year-on-year rate of increase in the CPI (all items less food and energy) for November 2013 had risen to 0.6 percent. A few of these members added that, on the back of resilient private consumption, firms were finding it easier to pass on costs to sales prices, and that such developments seemed likely to continue. Many members said that the year-on-year rate of increase in the CPI was likely to be around 1¼ percent for some time since the underlying inflation pressures -- such as an improvement in the aggregate supply and demand balance as well as the rise in medium- to long-term inflation expectations -- were likely to gradually increase, although the upward contribution from movements in energy-related goods would diminish. Meanwhile, one member, pointing to the possibility of the effects of the depreciation of the yen on prices having become larger, said that -- if a reversal in the recent trend of the yen's depreciation were to occur -- the pace of increase in annual CPI inflation could slow by more than expected. Members shared the recognition that inflation expectations appeared to be rising on the whole, considering the results of various surveys and other information. Regarding medium- to long-term inflation expectations, a few members noted that, although an increasing number of indicators suggested that such expectations were more or less unchanged, some recent indicators suggested that expectations were rising again. These members then expressed the view that the rising trend in these expectations was being maintained.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative. They shared the view that the monetary base had increased significantly, reflecting the progress in asset purchases by the Bank, and that firms' funding costs had been hovering at low levels. Members shared the recognition that firms continued to see financial institutions' lending attitudes as being on an improving trend, issuing conditions for CP continued to be favorable, and those for corporate bonds also remained favorable on the whole. As for firms' credit demand, they concurred that the amount outstanding of bank lending had been increasing moderately and that, in this situation, the year-on-year rate of growth in the money stock had been on a rising trend. Some members said that bank lending to small firms had recently been extended to those across a wider range of industries, and that the year-on-year rate of increase in the amount outstanding of such lending had been climbing.

C. Interim Assessment

Given the above assessment, with regard to the baseline scenario of the outlook for Japan's economic activity, members agreed that, while the economy would be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hikes, it was likely to continue growing at a pace above its potential, as a trend, broadly in line with the forecasts in the baseline scenario presented in the October 2013 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). Many members pointed out that the consumption tax hikes would have adverse effects on households' real income. At the same time, however, these members expressed the view that forces to mitigate the effects of a decrease in households' purchasing power would also be at work, partly because (1) various economic measures were to be carried out by the government, (2) the consumption tax hikes seemed to have already been factored in substantially among households, and (3) the rate hikes were likely to have the effect of alleviating households' future concerns over the fiscal condition and the social security system.

With regard to the baseline scenario of the outlook for Japan's prices, excluding the direct effects of the consumption tax hikes, members shared the recognition that the forecasts for the year-on-year rate of increase in the CPI (all items less fresh food) were broadly in line with those presented in the October 2013 Outlook Report. Most members expressed the view that the year-on-year rate of increase in the CPI was likely to follow a rising trend, reflecting factors such as the improvement in the aggregate supply and demand balance as well as the rise in medium- to long-term inflation expectations, and that the rate was likely to reach around 2 percent -- the price stability target -- toward the latter half of the projection period through fiscal 2015. As was the case when the October 2013 Outlook Report had been discussed, a few members held a more cautious view of the outlook for prices compared with the forecasts in the baseline scenario, mainly because it seemed highly uncertain whether changes in inflation expectations would lead to a rise in the actual rate of inflation.

Members shared the recognition that risks to the outlook included developments in the emerging and commodity-exporting economies, the prospects for the European debt problem, and the pace of recovery in the U.S. economy. With regard to the emerging and commodity-exporting economies, many members said that developments in these economies, some of which were facing structural problems such as current account deficits, continued to warrant attention together with developments in the global financial markets. In terms of the prospects for the European debt problem, some members pointed out that there was a risk that the disinflationary trend would increase the real debt burden, and that uncertainty remained regarding developments toward ensuring the soundness of the financial system. As for the U.S. economy, members shared the recognition that uncertainty surrounding future developments had declined since (1) the U.S. Congress had reached agreement on matters such as the size of fiscal expenditures and (2) the Federal Reserve had decided to begin reducing the pace of its asset purchases. Based on this discussion, they concurred that downside risks regarding overseas economies had been declining, particularly among the U.S. and European economies. Meanwhile, one member expressed the view that, in addition to the aforementioned risks concerning overseas economies, the pace of improvement in the employment and income situation in Japan could be considered a risk for the time being. On this point, some members said that indicators of the employment and income situation had in fact been improving recently and seemed likely to continue doing so, mainly on the back of the recovery in business performance.

III. Summary of Discussions on Monetary Policy for the Immediate Future

Based on the above assessment of economic and financial developments, members discussed monetary policy for the immediate future.

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that it was appropriate to maintain the current guideline that the

Bank would conduct money market operations so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

With regard to the asset purchases, members concurred that it was appropriate for the Bank to continue with the guidelines decided when it introduced quantitative and qualitative monetary easing at the meeting on April 3 and 4, 2013. Specifically, they confirmed the following. First, the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases would be about seven years. Second, it would purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding would increase at an annual pace of about 1 trillion yen and about 30 billion yen, respectively. And third, for CP and corporate bonds, the Bank would maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

With respect to the Bank's thinking behind its conduct of monetary policy, most members shared the recognition that the Bank would continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining this target in a stable manner. These members continued that, in doing so, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. Members expressed the view that it was appropriate for the Bank to continue to steadily pursue quantitative and qualitative monetary easing in accordance with the current guidelines, taking into account that Japan's economic and price developments had been broadly in line with the forecasts presented in October 2013 and that risks -- particularly those surrounding overseas economies -- had decreased.

On the other hand, one member said that, if a rise were to occur in markets' anticipation that quantitative and qualitative monetary easing would continue for a protracted period or extreme additional measures would be implemented in a situation where it was unlikely that the price stability target would be achieved in about two years, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, the member said that it was appropriate to change the expression representing the Bank's commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner. This member added that the Bank's communication associated with such a change would serve to mitigate each entity's tendency to be overly dependent on monetary policy.

With regard to the effects of quantitative and qualitative monetary easing, members shared the recognition that these continued to firmly take hold, and financial conditions were easing steadily to underpin firms' and households' spending. Regarding how much of an effect could be exerted on longer-term interest rates, they agreed that long-term interest rates in Japan had been stable at low levels under the Bank's massive JGB purchases. Members shared the recognition that, in a situation where nominal interest rates had been stable, real interest rates were declining on the back of a rise in inflation expectations. Meanwhile, one member -- while pointing out that households' holdings of stocks and investment trusts were expanding, as suggested by the *Flow of Funds Accounts* and broadly-defined liquidity -- expressed the view that portfolio rebalancing, mainly by households, was proceeding steadily.

With regard to mechanisms in which inflation expectations would rise, some members expressed the view that both of the following would operate: (1) a forward-looking mechanism in which fundamental changes in people's expectations would be encouraged mainly through quantitative and qualitative monetary easing; and (2) a backward-looking mechanism in which inflation expectations would rise in adapting to an actual increase in prices. On this basis, these members expressed the recognition that, in a situation where the observed inflation rate remained at around 1¼ percent on a year-on-year basis for some time, the backward-looking mechanism would operate more effectively than before, and so would the forward-looking mechanism as the price stability target of 2 percent gained more credibility.

Regarding the Bank's communication to the public, many members expressed the view that the Bank's determination to "achieve the price stability target of 2 percent at the earliest possible time, with a time horizon of about two years" and its clarified guideline -- namely, that it "will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner" -- constituted important components of its commitment and were mutually complementary. As for the time frame for continuing quantitative and qualitative monetary easing, many members expressed the recognition that it was necessary for the Bank to provide a clear explanation that it did not strictly set this to end in two years, to avoid any misunderstanding. At the same time, some members emphasized that the Bank should make sure that such an explanation would not weaken the commitment to "achieving the price stability target of 2 percent at the earliest possible time, with a time horizon of about two years." One member pointed to the need to increase recognition that the expression "as long as it is necessary" in the guideline indicated that the Bank would make judgments based on future prospects. In relation to this, one member added that it was important to give due consideration to the fact that the effects of monetary policy required a certain time lag to permeate economic activity and prices. Some members pointed out that the Bank should provide a clearer explanation to the public that the following was already factored into the Policy Board members' baseline scenario of the economic outlook -- that is, that the growth rate for the January-March quarter of 2014 would be elevated due to the front-loaded increase in demand prior to the consumption tax hike, and that the rate for the April-June quarter would temporarily drop as demand subsequently declined.

IV. Remarks by Government Representatives

The representative from the Ministry of Finance made the following remarks.

(1) The government deemed that, over the course of the year following the release of the joint statement by the government and the Bank on January 22, 2013, the Japanese economy had been moving steadily on an upward trend and prices had been resilient, due in part to the effects of the bold monetary easing. In its economic outlook for fiscal 2014, approved by the Cabinet on December 21, 2013, the government indicated that the Japanese economy was likely to make steady progress toward overcoming deflation in a situation where a virtuous cycle in economic activity was likely to be realized gradually. The government understood that the discussion at this meeting on the Bank's interim assessment of the October 2013 Outlook Report also confirmed the steady progress of the Japanese economy toward achieving the price stability target. It expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing and achieve the target at the earliest possible time.

(2) At the end of 2013, the Cabinet had decided the budget for fiscal 2014 and an outline for tax reform in fiscal 2014. The former aimed at (1) prioritizing placement within

the budget on measures toward strengthening the competitiveness of the Japanese economy, and (2) enhancing and maintaining the social security system by improving the efficiency of fiscal expenditures and utilizing the increased revenue from the consumption tax hike. Through these initiatives, the government had reduced the amount of newly issued government bonds and improved the primary balance of the general account by more than it had targeted in the Medium-Term Fiscal Plan. In terms of the latter, the government had devised measures including (1) tax breaks for capital investment, (2) expansion of the income growth promotion tax system, (3) abolition of the special corporate tax for reconstruction one year ahead of schedule, and (4) taxation measures to expand private investment and consumption. The government would work to promptly obtain the Diet's approval of these measures, in addition to the supplementary budget for fiscal 2013. With a view to creating a favorable environment for firms to raise wages, the government had formed a common understanding with labor and business communities about working in close cooperation to realize a positive cycle of the economy. Moreover, in order to promptly and steadily implement measures based on the Japan Revitalization Strategy, the government had worked to formulate an action plan in which the implementation period and the ministers in charge would be clarified for major measures, and had compiled the review guidelines for discussions that would take place in the immediate future for the purpose of achieving further progress with the growth strategy. Through these measures, the government would promote the stabilization of the social security system and pursue fiscal consolidation while securing a path toward overcoming deflation and revitalizing the economy.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was recovering at a moderate pace. In the government's economic outlook for fiscal 2014, it projected that, although due attention should be paid to the decline following the front-loaded increase in demand prior to the consumption tax hike, the real GDP growth rate would be around 1.4 percent, as the economy would recover, supported by firm domestic demand brought about mainly by pursuing various measures over the fiscal year as a whole. The government also projected that the Japanese economy would make steady progress toward overcoming

deflation, in view of, for example, the annual CPI inflation rate for fiscal 2014 -- excluding the effects of the consumption tax hike -- which was forecasted to be approximately 1.2 percent. The government deemed that its outlook was in line with that of the Bank.

(2) At the Council on Economic and Fiscal Policy held on January 20, 2014, the government had presented a statement on economic and fiscal projections for its medium- to long-term analysis and released the economic and fiscal prospects toward realizing a positive cycle. The medium- to long-term analysis indicated that, based on efforts by the government to improve the fiscal balance in line with the Medium-Term Fiscal Plan, the target of halving the national and local governments' primary deficit to GDP ratio in fiscal 2010 would be achieved by fiscal 2015. Nevertheless, as it indicated that the target of generating a surplus in the primary balance would not be achieved in fiscal 2020, the government recognized that further efforts to improve the primary balance were required. The government deemed it necessary to proceed with further deliberation to envisage a concrete path toward achieving the target. At the Council on Economic and Fiscal Policy, the government would work to implement concrete reforms by focusing, for example, on ensuring the consistency of macroeconomic policies, including monetary policy, and on acting in concert with micro growth strategies.

(3) With regard to the growth strategy, the government had formulated an action plan for enhancing the implementation of related measures in the future. Moreover, at the meeting of the Industrial Competitiveness Council held on January 20, 2014, the government had compiled the review guidelines for the progress of the growth strategy in preparation for the revision of the strategy scheduled for mid-year. It would work boldly to achieve further progress with the growth strategy.

(4) The government expected the Bank to achieve the price stability target of 2 percent, in line with the Bank's interim assessment of the October 2013 Outlook Report presented at this meeting. It also expected the Bank to continue providing a sufficient explanation on the state of its monetary policy conduct and its outlook for prices at the Council on Economic and Fiscal Policy and on other occasions.

V. Votes

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

To reflect this view, the chairman formulated the following proposal and put it to a vote.

The Chairman's Policy Proposal on the Guideline for Money Market Operations:

1. The guideline for money market operations for the intermeeting period ahead will be as follows.

> The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. A public statement will be decided separately.

> Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.
> Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy and formed a majority view. Mr. T. Kiuchi, however, formulated a proposal, and thus two proposals were submitted.

Meanwhile, Ms. S. Shirai expressed dissent from the description regarding risks to the outlook presented in the draft of the statement that formed a majority view, suggesting that the pace of improvement in the employment and income situation in Japan should be added. As the reason for this, she stated that, for domestic demand to continue to maintain its firmness in the future, it was important to maintain a virtuous cycle whereby improvement in the employment and income situation supported consumption, as noted in the October 2013 Outlook Report, and that this point should be included as one of the risks for the time being.

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T. Kiuchi proposed changing the current expression of the Bank's future monetary policy stance that "the Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" to a new expression that "the Bank will aim to achieve the price stability target of 2 percent in the medium to long term. On this basis, it will designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years, and thereafter will review the monetary easing measures in a flexible manner." The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. T. Kiuchi.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.

B. The Chairman's Policy Proposal

The chairman formulated the Statement on Monetary Policy, and put it to a vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of December 19 and 20, 2013 for release on January 27, 2014.

Attachment
January 22, 2014
Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote, to set the following guideline for money market operations for the intermeeting period:

   The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. With regard to the asset purchases, the Bank will continue with the following guidelines:

   a) The Bank will purchase Japanese government bonds (JGBs) so that their amount outstanding will increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases will be about seven years.

   b) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at an annual pace of about 1 trillion yen and about 30 billion yen respectively.

   c) As for CP and corporate bonds, the Bank will maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen respectively.

3. Japan's economy has continued to recover moderately, and a front-loaded increase in demand prior to the consumption tax hike has recently been observed. Overseas economies -- mainly advanced economies -- are starting to recover, although a lackluster performance is still seen in part. In this situation, exports have generally been picking up. Business fixed investment has been picking up as corporate profits have improved. Public investment has continued to increase. With improvement in the employment and income situation, housing investment has continued to increase and private consumption has remained resilient; in these segments of the economy, the front-loaded increase in demand prior to the consumption tax hike has also been observed. Reflecting these developments in demand both at home and abroad, industrial production has been increasing moderately. Meanwhile, financial conditions are accommodative. On the price front, the year-on-year rate of increase in the

consumer price index (CPI, all items less fresh food) is around 1¼ percent. Inflation expectations appear to be rising on the whole.

4. With regard to the outlook, Japan's economy is expected to continue a moderate recovery as a trend, while it will be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike. The year-on-year rate of increase in the CPI, excluding the direct effects of the consumption tax hike, is likely to be around 1¼ percent for some time.

5. Compared with the forecasts presented in the October 2013 *Outlook for Economic Activity and Prices*, the growth rate and year-on-year rate of increase in the CPI will likely be broadly in line with the October forecasts.

6. Risks to the outlook include developments in the emerging and commodity-exporting economies, the prospects for the European debt problem, and the pace of recovery in the U.S. economy.[Note 1]

7. The Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.[Note 2]

   Such conduct of monetary policy will support the positive movements in economic activity and financial markets, contribute to a rise in inflation expectations, and lead Japan's economy to overcome the deflation that has lasted for nearly 15 years.

[Note 1] Ms. S. Shirai dissented from the description in paragraph 6, suggesting that the pace of improvement in the employment and income situation in Japan should be added.

[Note 2] Mr. T. Kiuchi proposed that the Bank will aim to achieve the price stability target of 2 percent in the medium to long term and designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years. The proposal was defeated by an 8-1 majority vote. Voting for the proposal: Mr. T. Kiuchi. Voting against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.

(Appendix 1)

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2013	+2.5 to +2.9 [+2.7]	+0.7 to +0.9 [+0.7]	
Forecasts made in October 2013	+2.6 to +3.0 [+2.7]	+0.6 to +1.0 [+0.7]	
Fiscal 2014	+0.9 to +1.5 [+1.4]	+2.9 to +3.6 [+3.3]	+0.9 to +1.6 [+1.3]
Forecasts made in October 2013	+0.9 to +1.5 [+1.5]	+2.8 to +3.6 [+3.3]	+0.8 to +1.6 [+1.3]
Fiscal 2015	+1.2 to +1.8 [+1.5]	+1.7 to +2.9 [+2.6]	+1.0 to +2.2 [+1.9]
Forecasts made in October 2013	+1.3 to +1.8 [+1.5]	+1.6 to +2.9 [+2.6]	+0.9 to +2.2 [+1.9]

Notes: 1. Figures in brackets indicate the median of the Policy Board members' forecasts (point estimates).

2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

3. Individual Policy Board members make their forecasts assuming the effects of past policy decisions and with reference to views incorporated in financial markets regarding future policy.

4. The scheduled consumption tax hikes for April 2014 and October 2015 -- to 8 percent and 10 percent, respectively -- are incorporated in the forecasts. In terms of the outlook for the CPI, individual Policy Board members make their forecasts based on figures excluding the direct effects of the consumption tax hikes.

5. The forecasts for the CPI for fiscal 2014 and fiscal 2015 that incorporate the direct effects of the consumption tax hikes are constructed as follows. First, the contribution to prices from each tax hike is mechanically computed on the assumption that the tax increase will be fully passed on for all taxable items. The CPI for fiscal 2014 and fiscal 2015 will be pushed up by 2.0 percentage points and 0.7 percentage point, respectively. Second, these figures are added to the forecasts made by the Policy Board members.

6. The ranges shown below include the forecasts of all Policy Board members.

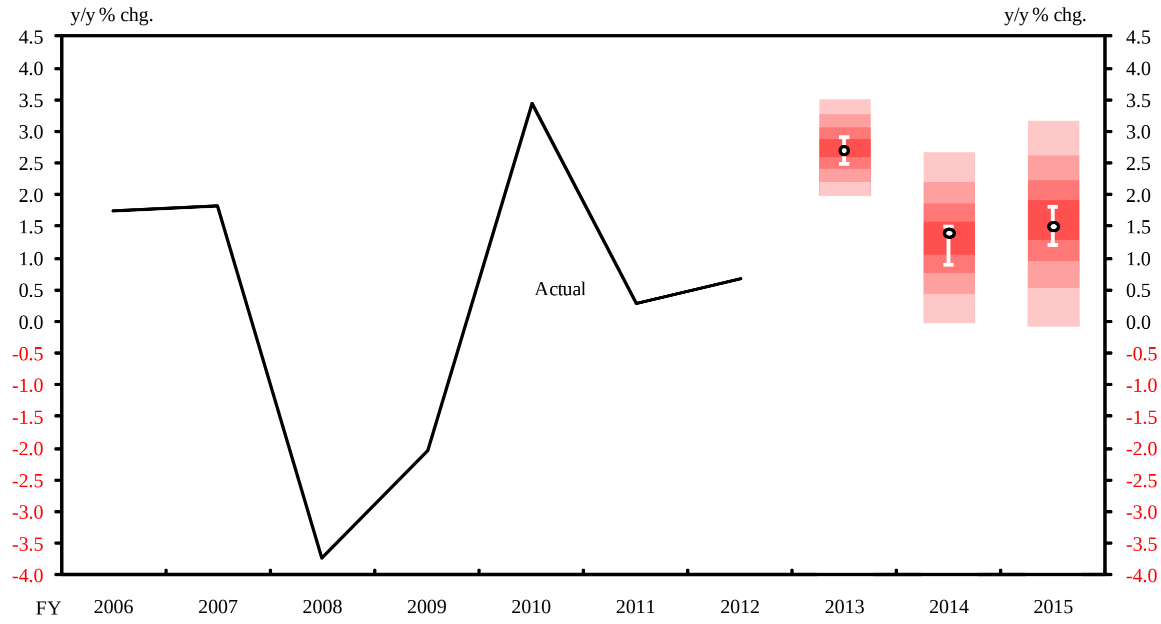
y/y % chg.

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2013	+2.5 to +3.0	+0.7 to +0.9	
Forecasts made in October 2013	+2.6 to +3.0	+0.6 to +1.0	
Fiscal 2014	+0.6 to +1.6	+2.7 to +3.7	+0.7 to +1.7
Forecasts made in October 2013	+0.5 to +1.6	+2.6 to +3.7	+0.6 to +1.7
Fiscal 2015	+1.2 to +2.0	+1.5 to +2.9	+0.8 to +2.2
Forecasts made in October 2013	+1.2 to +2.0	+1.4 to +2.9	+0.7 to +2.2

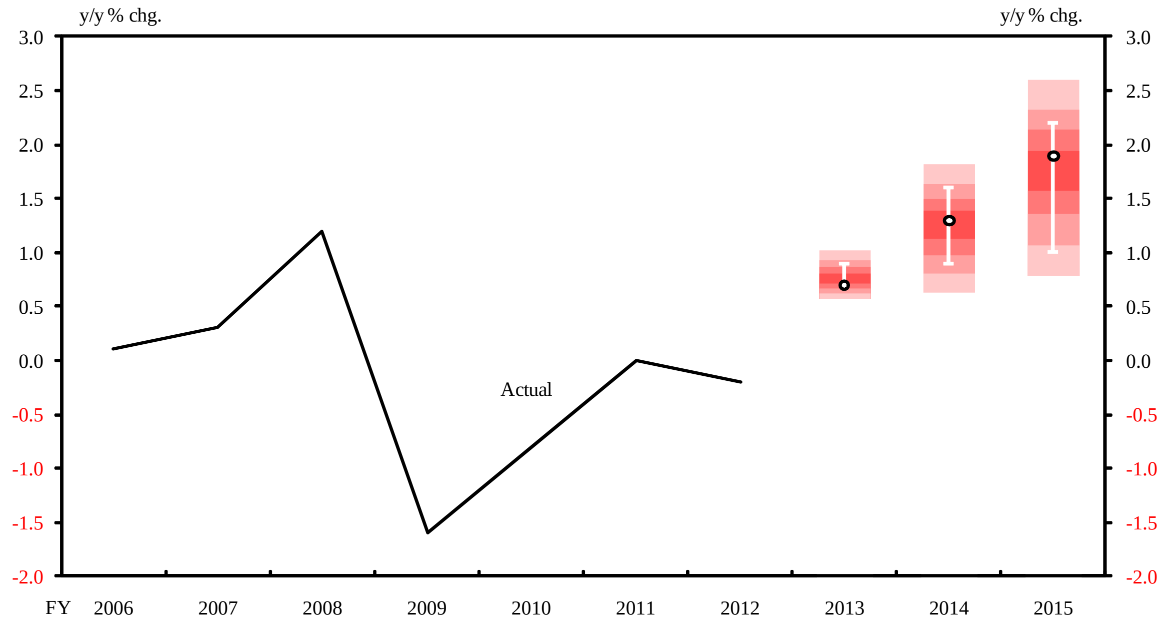
(Appendix 2)

Forecast Distribution Charts of Policy Board Members

(1) Real GDP



(2) CPI (All Items Less Fresh Food)



Notes: 1. Based on the aggregated probability distributions (i.e., the Risk Balance Charts) compiled from the distributions of individual Policy Board members, the Forecast Distribution Charts are compiled as follows. First, upper and lower 10 percentiles of the aggregated distributions are trimmed and second, colors indicated below are used to show the respective percentiles of those distributions.

Upper 40% to lower 40%	Upper 30 to 40% & lower 30 to 40%	Upper 20 to 30% & lower 20 to 30%	Upper 10 to 20% & lower 10 to 20%

2. For the process of compilation of the Risk Balance Charts, see the box on page 9 of the April 2008 *Outlook for Economic Activity and Prices* .

3. The circles in the bar charts indicate the median of the Policy Board members' forecasts (point estimates). The vertical lines in the bar charts indicate the range of the forecasts of the majority of Policy Board members.

4. The forecast for the CPI excludes the direct effects of the scheduled consumption tax hikes.