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November 7, 2016

Bank of Japan

Minutes of the Monetary Policy Meeting

on September 20 and 21, 2016

(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, September 20, 2016, from 2:00 p.m. to 4:04 p.m., and on Wednesday, September 21, from 9:00 a.m. to 12:58 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. T. Sato
Mr. T. Kiuchi
Mr. Y. Harada
Mr. Y. Funo
Mr. M. Sakurai
Ms. T. Masai

Government Representatives Present

Mr. T. Otsuka, State Minister of Finance, Ministry of Finance[2]
Mr. M. Ota, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. T. Ochi, State Minister of Cabinet Office, Cabinet Office[2]
Mr. S. Habuka, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. M. Amamiya, Executive Director
Mr. S. Kushida, Executive Director[4]
Mr. S. Kuwabara, Executive Director

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on October 31 and November 1, 2016 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. T. Otsuka and T. Ochi were present on September 21.

[3] Messrs. M. Ota and S. Habuka were present on September 20.

[4] Mr. S. Kushida was present on September 20 from 3:10 p.m. to 3:35 p.m.

Mr. E. Maeda, Executive Director (Assistant Governor)

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

Mr. H. Chida, Deputy Director-General, Monetary Affairs Department[5]

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

Mr. Y. Yamada, Director-General, Financial System and Bank Examination Department[6]

Mr. S. Shimizu, Director-General, Financial Markets Department

Mr. T. Sekine, Director-General, Research and Statistics Department

Mr. K. Nakamura, Head of Economic Research Division, Research and Statistics Department

Mr. S. Nagai, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. R. Yanagihara, Director-General, Secretariat of the Policy Board

Mr. H. Nakamoto, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. K. Suzuki, Head of Policy Infrastructure Division, Monetary Affairs Department[5]

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

Mr. K. Tamura, Senior Economist, Monetary Affairs Department

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

Mr. A. Okuno, Head of Market Operations Division, Financial Markets Department[6]

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[5] Messrs. H. Chida and K. Suzuki were present on September 20 from 3:35 p.m. to 4:04 p.m., and on September 21 for the whole of the session.

[6] Messrs. Y. Yamada and A. Okuno were present on September 20 from 3:10 p.m. to 3:35 p.m. and from 3:35 p.m. to 4:04 p.m., respectively.

I. Summary of Staff Reports on Economic and Financial Developments[7]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on July 28 and 29, 2016, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[8] In this situation, the amount outstanding of the monetary base had been in the range of 395-408 trillion yen.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had generally been in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.03 to minus 0.06 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had been in the range of around minus 0.2 to minus 0.3 percent.

The Nikkei 225 Stock Average had increased moderately, and was moving at around 16,500 yen recently. In the foreign exchange market, the yen had appreciated temporarily against the U.S. dollar, mainly in response to some weaker-than-expected U.S. economic indicators. Thereafter, it had depreciated, albeit with fluctuations, partly reflecting speculation about the direction of monetary policy in Japan and the United States. Meanwhile, the yen had appreciated marginally against the euro. In a situation where long-term interest rates had risen globally, yields on 10-year JGBs had increased, mainly against the background of speculation about the direction of the Bank's monetary policy.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow at a moderate pace, but the pace of growth had somewhat decelerated, mainly in emerging economies.

The U.S. economy had been on a recovery trend, assisted by firmness in the employment and income situation and in household spending, although the industrial sector had lacked momentum, mainly against the background of the slowdown in emerging economies. As for prices, the year-on-year rate of increase in the personal consumption

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[7] Reports were made based on information available at the time of the meeting.

[8] 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 80 trillion yen.

expenditure (PCE) deflator for all items excluding food and energy had been in the range of 1.5-2.0 percent. That for all items had been at around 1.0 percent, mainly due to the decline in energy prices.

The European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness. With regard to prices, the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items had been at around 0 percent, mainly due to the decline in energy prices, but that for all items excluding energy and unprocessed food had been at around 1 percent. Meanwhile, economic activity in the United Kingdom continued to recover, but the pace of recovery had slowed somewhat. The impact of the United Kingdom's vote to leave the European Union (EU) on its economic activity was difficult to assess in a situation where consumer confidence had worsened sharply after the referendum, while other indicators had fluctuated largely.

With regard to emerging economies, the Chinese economy remained slightly subdued, mainly in exports and production, but maintained its stable growth on the whole. In India, the economy had been growing steadily, particularly in domestic demand, partly in reflection of expectations for structural reforms and of monetary easing effects. On the other hand, economic activity in the NIEs and the ASEAN countries had been somewhat subdued as exports and production continued to be weak. Economic activity in Brazil and Russia remained severe but had bottomed out, mainly due to a halt in the decline in commodity prices. As for prices in emerging economies, inflation rates had been more or less flat at low levels in many countries and regions. Those in Brazil and Russia remained at high levels but had been declining, due to a pause in the depreciation of their currencies.

Regarding global financial markets, prices of risky assets -- including stock prices in advanced and emerging economies -- had risen, due mainly to expectations regarding accommodative policy conduct by central banks in advanced economies. However, market volatility had heightened temporarily from September 2016, amid the situation of a rise in long-term interest rates in advanced economies that mainly reflected speculation about the timing of a hike in the target range for the federal funds rate in the United States.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy continued its moderate recovery trend, although exports and production had been sluggish, due mainly to the effects of the slowdown in emerging economies.

Exports had been more or less flat. Those to advanced economies, mainly automobile-related, continued increasing steadily when temporary fluctuations were smoothed out, whereas those to emerging economies had been sluggish, especially of capital goods and parts. Exports were projected to remain more or less flat as a trend for some time, as the slowdown in overseas economies continued and the recent appreciation of the yen exerted downward pressure. Thereafter, they were expected to increase moderately as overseas economies moved out of their deceleration phase.

The decline in public investment had leveled off. Such investment was likely to increase moderately, particularly in that related to the creation and improvement of infrastructures accompanying measures for restoration and rebuilding following the Kumamoto Earthquake and the economic stimulus package.

Business fixed investment had been on a moderate increasing trend as corporate profits had been at high levels. Looking at the *Financial Statements Statistics of Corporations by Industry, Quarterly*, the ratio of current profits to sales had declined, albeit remaining at a high level, but picked up somewhat in the April-June quarter of 2016, driven by large nonmanufacturing firms. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, business fixed investment for all industries continued a moderate increasing trend, albeit with some fluctuations. Machinery orders -- a leading indicator of business fixed investment -- continued to increase moderately, albeit with some fluctuations. Business fixed investment as a whole was likely to maintain its moderate increasing trend on the back of corporate profits at high levels, although that in manufacturing firms was likely to temporarily show some weakness due to a decline in corporate profits and heightened uncertainties surrounding overseas economies.

As for the employment and income situation, supply-demand conditions in the labor market continued to improve steadily and employee income had increased moderately.

Private consumption had been resilient against the background of steady improvement in the employment and income situation, although relatively weak developments had been seen in some indicators. The consumption activity index had been somewhat weak since early 2016 but had shown signs of improvement recently. According to various sales statistics, retail sales for January through March had been somewhat weak due to negative wealth effects stemming from the decline in stock prices, in addition to supply-side constraints in terms of automobiles caused by a steel plant accident. However, such sales for April through June had picked up, mainly due to the recovery in automobile sales, and continued to do so for July. Private consumption was expected to increase its resilience gradually, with the negative wealth effects brought about by the decline in stock prices dissipating, and with the employment and income situation continuing to improve steadily.

Housing investment continued picking up, underpinned partly by accommodative financial conditions.

Industrial production continued to be more or less flat, due to the slowdown in emerging and commodity-exporting economies. As for the outlook, although it was likely to be pushed up in the short run by the accelerated production of automobiles to make up for the earlier disruption, industrial production was projected to remain more or less flat as a trend for some time in a situation where the effects of the slowdown in overseas economies exerted downward pressure.

As for prices, the rate of decline in the producer price index (PPI) relative to three months earlier had been on a decelerating trend, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the consumer price index (CPI) for all items less fresh food had been slightly negative. The rate of increase for all items less fresh food and energy had registered 0.5 percent year-on-year for July. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to be slightly negative or about 0 percent for the time being, due to the effects of the decline in energy prices.

2. Financial environment

Financial conditions were highly 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 25 percent.

Firms' funding costs had been hovering at extremely low levels. With regard to credit supply, financial institutions' lending attitudes -- as perceived by firms -- had been highly accommodative. Issuing conditions for CP and corporate bonds had been favorable. Firms' credit demand had been increasing moderately, such as for funds related to mergers and acquisitions, as well as for funds for business fixed investment. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been around 2 percent. Firms' financial positions had been favorable. The year-on-year rate of growth in the money stock had been in the range of 3.0-3.5 percent, as bank lending had increased. Meanwhile, although inflation expectations appeared to be rising on the whole from a somewhat longer-term perspective, they had weakened recently.

3. Loan disbursement through the Loan Support Program

In early September 2016, the Bank carried out a new loan disbursement, amounting to 443.7 billion yen, under the main rules for the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth. The outstanding balance of loans disbursed by the Bank under these rules amounted to 5,943.3 billion yen after the new loan disbursement. The outstanding balance of loans disbursed by the Bank under the special rules for equity investments and asset-based lending (ABL) came to 69.6 billion yen, and that under the special rules for small-lot investments and loans amounted to 12.149 billion yen. As for the special rules for the U.S. dollar lending arrangement, the outstanding balance of loans came to 12.00 billion dollars.

On September 16, the Bank was scheduled to carry out a new loan disbursement, amounting to 4,950.2 billion yen, under the Fund-Provisioning Measure to Stimulate Bank Lending. The outstanding balance of loans disbursed by the Bank would amount to 27,997.9 billion yen after the new loan disbursement.

II. Amendment to Guidelines on Eligible Collateral

A. Staff Proposal

The staff proposed that the Bank make necessary amendments, including those to its Guidelines on Eligible Collateral and the principal terms and conditions for repo operations and securities lending, in order to reflect the results of the Bank's annual review of appropriate margins for eligible collateral in light of recent developments in financial markets.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the proposal and agreed that the decision should be made public.

III. Change in the Amount of Each Exchange-Traded Fund (ETF) to Be Purchased

A. Staff Reports

The Bank had set the amount of each ETF to be purchased so that its purchases would be roughly proportionate to the total market value of that ETF issued, and this consequently had given rise to a situation in which some stocks tended to become scarce in the market. The staff therefore proposed making the following changes to the amount of each ETF to be purchased.

(1) Of the annual purchase amount of 5.7 trillion yen, 3 trillion yen would be used, as before, for ETFs that tracked any of the three indices -- the Tokyo Stock Price Index (TOPIX), the Nikkei 225 Stock Average, or the JPX-Nikkei Index 400 (JPX-Nikkei 400). The amount of each ETF to be purchased should be set so that the Bank's purchases would be roughly proportionate to the total market value of that ETF issued.

(2) The remaining 2.7 trillion yen would be used for ETFs that tracked the TOPIX. The amount of each ETF to be purchased should be set so that the Bank's purchases would be roughly proportionate to the total market value of that ETF issued.

B. Discussion by the Policy Board and Vote

In response to the staff's explanation, members concurred that it was appropriate to change the amount of each ETF to be purchased, as proposed by the staff. "Amendment to 'Principal Terms and Conditions for Purchases of ETFs and J-REITs,'" which represented the aforementioned staff reports, was put to a vote. Members voted unanimously to approve the proposal. They concurred that the staff should make this public immediately after the meeting.

IV. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of July 28 and 29, 2016 for release on September 27.

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

A. Economic Developments

Members shared the recognition that, although global financial markets had regained their calmness for now after the turbulence following the United Kingdom's referendum, there remained high uncertainties, as seen, for example, in the temporary swings in the markets, mainly reflecting speculation about the timing of a hike in the target range for the federal funds rate in the United States. One member said that due attention should continue to be paid to developments in global financial markets, considering (1) uncertainty over the timing that Article 50 of the Lisbon Treaty -- which stipulated the withdrawal process of a member state from the EU -- would come into effect, and (2) the swings in the markets, mainly reflecting speculation about the policy interest rate hike by the Federal Reserve.

Members shared the recognition that overseas economies continued to grow at a moderate pace, but the pace of growth had somewhat decelerated, mainly in emerging economies. As for the outlook, they shared the view that overseas economies as a whole were likely to moderately increase their growth rates, as it was likely that advanced economies would continue to see steady growth and emerging economies would move out of their deceleration phase on the back of the developments in advanced economies and emerging economies' policy effects. Some members noted that the impact of the United Kingdom's vote to leave the EU had been limited so far and there had been no change in the situation of moderate growth in advanced economies.

With regard to developments in overseas economies by region, members concurred that the U.S. economy had been on a recovery trend, assisted by firmness in household spending that reflected an improving trend in the employment and income situation, although the industrial sector had lacked momentum, mainly against the background of the slowdown in emerging economies. One member said that there was concern regarding heightening uncertainty over the presidential election, but the real economy continued to see moderate growth led by private consumption. As for the outlook, members shared the view that the economy was likely to continue to grow, mainly in private demand, led by the firmness in household spending, reflecting accommodative financial conditions, although it was likely to lack momentum in the short run due to the flattening of industrial production against the background of sluggishness in external demand. One member noted that attention on the timing of the policy interest rate hike by the Federal Reserve would be warranted given, for example, mixed economic indicators and uncertainties surrounding overseas economies.

Members shared the recognition that the European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness. As for the outlook, they concurred that the economy would likely continue to see a moderate recovery, although external demand was likely to lack momentum. Members also shared the recognition that there was high uncertainty regarding the impact that the United Kingdom's vote to leave the EU would have on the European economy, and therefore this required close monitoring. One member said that, so far, the United Kingdom's vote to leave the EU had not had as much of an effect as feared; nevertheless, it was necessary to continue to closely monitor its impact considering mixed European economic indicators.

Members agreed that the Chinese economy remained slightly subdued, mainly in exports and production, but maintained its stable growth on the whole. As for the outlook, they shared the view that the economy was likely to broadly follow a stable growth path as authorities proactively carried out measures to support economic activity, although the growth pace was likely to be somewhat slower, mainly in exports and production. One member said that domestic demand had been recovering moderately, due in part to the effects of the government's economic stimulus measures. The member continued that it nevertheless was necessary to closely monitor whether or not financial imbalances had been built up, as partly implied by the expansion in real estate-related credit.

Members shared the view that emerging economies had been decelerating, mainly in exports and production. One member noted that stable commodity prices had been exerting favorable effects on some economies. As for the outlook, members shared the view that emerging economies were likely to remain subdued, but that the growth rates subsequently were likely to increase gradually, due mainly to the effects of the economic stimulus measures both on the fiscal and monetary fronts and the spread of the effects of the recovery in advanced economies.

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 recognition that the economy continued its moderate recovery trend, although exports and production had been sluggish, due mainly to the effects of the slowdown in emerging economies.

Members agreed that Japan's exports had been more or less flat, due mainly to the effects of the slowdown in emerging economies. As for the outlook, they shared the view that, although exports were likely to remain more or less flat for some time, they were likely to increase moderately thereafter as overseas economies moved out of their deceleration phase.

Members agreed that business fixed investment had been on a moderate increasing trend as corporate profits had been at high levels. They shared the view that such investment as a whole was likely to maintain its moderate increasing trend on the back of corporate profits at high levels. However, a few members noted that, if the yen appreciated further, it would be necessary to pay close attention to whether this would cause firms to postpone their fixed investment plans due to a deterioration in their sentiment.

As for the employment and income situation, members agreed that supply-demand conditions in the labor market continued to improve steadily and employee income had increased moderately. They concurred that employee income was likely to continue to do so as labor market conditions kept improving and corporate profits remained at high levels. One member said that the challenge from now on was to bring about an acceleration in the uptrend in wages, and that, to this end, deregulation and reform of the labor market would be an important factor.

Members agreed that private consumption had been resilient against the background of steady improvement in the employment and income situation, although relatively weak developments had been seen in some indicators. One member said that, in a situation where employee income had been firm, owing in part to the increase in summer bonus payments, consumer sentiment had shown a pick-up, as suggested by the *Economy Watchers Survey*. A different member noted that a pick-up had been observed in households' sentiment, due in part to the recent recovery in stock prices. In the outlook, many members shared the view that private consumption was likely to increase its resilience gradually, with the negative wealth effects brought about by the decline in stock prices dissipating, and with the employment and income situation continuing to improve steadily. One member said that, in order for private consumption to increase firmly, it was important to create an environment in which it could be assured that the current favorable employment and income situation was not temporary but sustainable, and that wages would rise. A different member noted that, while the current fall in the propensity to consume was due to various factors, it was partly attributable to the subsequent decline in durable consumer goods demand that had been stimulated by the measures implemented after the global financial crisis.

As for housing investment, members shared the recognition that it continued picking up, underpinned partly by accommodative financial conditions.

Members shared the recognition that industrial production continued to be more or less flat, due to the slowdown in emerging and commodity-exporting economies. As for the outlook, they shared the view that it was likely to remain more or less flat for some time due to continued effects of the slowdown in overseas economies.

As for prices, members shared the recognition that the year-on-year rate of change in the CPI (all items less fresh food) had been slightly negative. Most members concurred that it was likely to remain so or be about 0 percent for the time being, due to the effects of the decline in energy prices, and, as the underlying trend in inflation steadily rose, accelerate toward 2 percent. On this basis, some members noted that, depending on developments such as in private consumption and foreign exchange rates, firms' cautious price-setting behavior might continue for longer than expected. These members added that attention therefore should be paid to the downside risks to prices. A different member said that, in combination with monetary easing measures, the government's large-scale stimulus package that was to be implemented was expected to contribute to a rise in the economic growth rate and an improvement in inflation expectations. Another member noted that commodity prices had been fluctuating within a certain range -- albeit at a low level -- and the downward pressure on consumer prices was likely to gradually dissipate. However, the member also noted that attention needed to be paid to inflation expectations having been under downward pressure through an adaptive formation mechanism. One member commented that the recent decline in various indicators of medium- to long-term inflation expectations suggested that the inflation expectations were reverting to the equilibrium level that was consistent with the current economic structure.

B. Financial Developments

Members concurred that financial conditions in Japan were highly accommodative.

They shared the view that, under Quantitative and Qualitative Monetary Easing (QQE) with a Negative Interest Rate, firms' funding costs had been hovering at very low levels.

VI. Summary of Staff Reports and Discussions by the Policy Board on "Comprehensive Assessment: Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)"

A. Staff Reports

The staff reported the following, based on their analysis of developments in economic activity and prices as well as policy effects over the three years since the introduction of QQE.

First was with regard to <u>the effects of monetary easing and reasons why the price stability target of 2 percent had not been achieved</u>. QQE had served to improve economic activity and price developments through the main transmission mechanism associated with lowered real interest rates, and Japan's economy was no longer in deflation. However, the price stability target of 2 percent had not been achieved, due mainly to the following factors: (1) exogenous developments -- including the decline in crude oil prices, weakness in demand following the consumption tax hike in April 2014, and volatility in the markets arising from the slowdown in emerging economies -- had lowered the observed inflation rate, and (2) inflation expectations had weakened, reflecting the fact that expectation formation in Japan was largely adaptive; that is, backward-looking. Since the observed inflation rate was likely to remain subdued for the time being, a further rise in inflation expectations through the adaptive mechanism was uncertain, and this highlighted the important role played by the forward-looking expectation formation mechanism. On this point, the relationship between the monetary base and inflation expectations seemed to be of a long-run rather than a short-run nature. Therefore, what was important was the Bank's commitment to expanding the monetary base in the long run.

Next, with regard to <u>the effects and impact of the negative interest rate</u>, it had been confirmed that the combination of the negative interest rate policy and JGB purchases was an effective means to push down short-term and long-term interest rates. The decline in JGB yields brought about by these policy measures had translated firmly into a decline in lending rates as well as interest rates on corporate bonds and CP. However, the decline in lending rates had been brought about by reducing financial institutions' profits. A decline in long-term and super-long-term interest rates lowered the rates of return on insurance and pension products, and attention needed to be paid to the possibility that this could have a negative impact on economic activity through a deterioration in people's sentiment.

B. Discussions by the Policy Board

Based on the above staff reports, members discussed the "Comprehensive Assessment."

First, with regard to the effects of QQE, many members shared the view that QQE had lowered real interest rates by raising inflation expectations and pushing down nominal interest rates, and had served to improve economic activity and price developments; as a result, Japan's economy was no longer in deflation, which was commonly defined as a sustained decline in prices. These members expressed the view that the expansion of the monetary base, together with the commitment to achieving the price stability target and the Bank's purchases of JGBs, by bringing about a regime change in monetary policy, had transformed people's perceptions of inflation and had led to a rise in inflation expectations. One member said that QQE had pushed up the observed inflation rate through raising inflation expectations, and had improved the employment and income situation, partly supported by the government's stimulus package. A different member noted that, under QQE, economic activity had improved significantly and lending continued to increase. In response, a few members said that the marginal effects of interest rate declines on the economy had been diminishing gradually, and an assessment focused on the policy's cumulative effects could lead to overestimation of them. One of these members said that the reason QQE had exerted significant positive effects on economic activity and price developments at the time of introduction was because the drastic policy change created a chance to correct the overvaluation of the yen and undervaluation of stock prices. The member continued that these positive effects had in part disappeared with a time lag as these corrections had run their course.

As for factors behind the situation of the price stability target of 2 percent having not been achieved, most members shared the recognition that the major reasons were that (1) exogenous developments -- including the decline in crude oil prices, weakness in demand following the consumption tax hike in April 2014, and the slowdown in emerging economies, as well as the resultant volatility in global financial markets -- had lowered the observed inflation rate, and (2) inflation expectations had weakened, reflecting the fact that expectation formation in Japan was largely adaptive; that is, backward-looking. One member said that factors such as the decline in crude oil prices could not be controlled by central banks, and that the essence of the problem was not the exogenous developments themselves, but that these developments had lowered the observed inflation rate, thereby pushing down inflation expectations. A different member said that the adaptive component continued to play a large role compared to other countries in terms of the formation of inflation expectations in Japan, and that in order to achieve the price stability target of 2 percent, some sort of measures to strengthen the forward-looking expectation formation mechanism were warranted. In relation to this, one member pointed out that the decline in inflation expectations had been a factor constraining wage increases. On this basis, the member said that the slowdown in wage growth had lowered the inflation rate and caused a further decline in inflation expectations, and that in order to put an end to this vicious circle, it was necessary to implement monetary policy that would raise inflation expectations. Many members expressed the view that inflation expectations needed to be raised further in order to achieve the price stability target of 2 percent; however, it should be noted that, since the observed inflation rate was likely to remain subdued for the time being, a further rise in inflation expectations through the adaptive mechanism was uncertain and might take time.

With respect to the effects and impact of the negative interest rate, many members noted that the negative interest rate policy introduced by the Bank in January 2016, in combination with JGB purchases, had pushed down not only short-term but also long-term interest rates substantially. Members shared the recognition that, even after this introduction, the decline in JGB yields had translated firmly into a decline in lending rates and interest rates on corporate bonds. One member said that QQE with a Negative Interest Rate had exerted notable effects in lowering the yield curve, and lending rates and interest rates on corporate bonds had declined further. The member continued that this provided clear evidence that the negative interest rate policy complemented the effects of QQE. Counter to this view, one member expressed the opinion that the change in the yield curve after the introduction of the negative interest rate policy had been largely induced by temporary and somewhat speculative moves, such as life insurers' purchases of super-long-term JGBs to reduce the duration gap of their assets and liabilities.

Members shared the recognition that due attention should be paid to the impact of the negative interest rate policy on financial institutions' profits. On this point, they shared the view that the extent to which a further decline in the yield curve would lead to a decline in lending rates depended on its impact on financial institutions' profits and their resultant lending stance going forward. Members also shared the recognition that an excessive decline and flattening of the yield curve might have a negative impact on economic activity by leading to a deterioration in people's sentiment, as it could lower the rate of return on insurance and pension products, for example, and thereby cause uncertainty about the sustainability of financial functioning in a broader sense. One member -- noting that the functioning of financial intermediation had not been impaired so far -- said that, in continuing with the Bank's large-scale monetary easing, it was necessary to form an appropriate yield curve with due consideration to the impact on financial conditions. A different member commented that, if the Bank could control the yield curve appropriately, this would increase the effectiveness of its monetary easing policy and ensure the sustainability of financial functioning. One member said that the effects of monetary easing should be analyzed in view of the following factors: (1) the impact on the profitability of financial institutions; (2) the impact of the lower profitability of financial institutions on the economy as a whole; and (3) the positive impact of monetary easing on the economy through channels other than financial intermediation, and added that the extent to which the second and third factors would exert effects on the economy as a whole was particularly important. The member then noted that, if the economy as a whole improved, the profitability of financial institutions also would improve on the back of a decline in credit costs, an increase in nominal interest rates, and an expansion of lending.

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

Based on the above deliberations, members discussed the directions to take on monetary policy.

Members shared the view that, in order to achieve the price stability target of 2 percent, it was necessary to raise inflation expectations, which had weakened, toward 2 percent. Most members expressed the recognition that measures to strengthen the forward-looking expectation formation mechanism were warranted, as the adaptive component continued to play a relatively large role compared to other countries in terms of the formation of inflation expectations in Japan. Many members shared the view that, in light of such measures, it was appropriate for the Bank to strengthen its commitment to achieving the price stability target. On this basis, a few members expressed the view that, specifically, it was appropriate for the Bank to adopt the so-called inflation-overshooting commitment, in which it committed itself to expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeded the price stability target of 2 percent and stayed above the target in a stable manner. The members said that it was exceptional for a central bank to commit itself to continuing with monetary easing until the year-on-year rate of increase in the observed CPI exceeded 2 percent, considering that there was a time lag until monetary policy took effect. The members continued that, because the commitment was exceptional, the effectiveness of exerting influence on households' and firms' formation of inflation expectations would be significant. One of these members noted that the commitment based on the observed CPI also had been adopted in the quantitative easing policy introduced by the Bank in 2001, but the commitment at that time was to continue with monetary easing until the year-on-year rate of change in the observed CPI registered stably 0 percent or an increase. The member continued that, relative to the 2001 commitment, the Bank's commitment to continue with monetary easing until the year-on-year rate of increase in the observed CPI exceeded the price stability target of 2 percent and stayed above the target in a stable manner was strong. A different member expressed the view that the inflation-overshooting commitment would contribute to raising inflation expectations by drawing more attention to the price stability target and thereby strengthening the forward-looking expectation formation mechanism. Another member said that, although it was not easy to change people's perceptions of inflation, the inflation-overshooting commitment was an effective means of showing that the Bank was strongly determined to achieve the price stability target. One member commented that, although introduction of such a strong commitment might induce side effects of accelerating inflation, this was very unlikely under the baseline scenario, which assumed that inflation expectations would increase moderately. On this basis, the member noted that, if by any chance inflation expectations were to increase rapidly, it was possible for the Bank to cope with the situation by raising interest rates. Counter to these views, one member said that the inflation-overshooting commitment was not a realistic target in light of the growth potential, and would not be effective for raising inflation expectations either.

Regarding the commitment targets, a few members expressed the view that, given that the Bank's commitment to achieving the price stability target, as well as the expansions of its balance sheet and the monetary base underpinning its commitment, had led to a rise in inflation expectations, introduction of the commitment to expand the monetary base would be effective. Counter to this view, one member noted that a long-run relationship between the monetary base and inflation expectations was not observed, while a relationship might have appeared through an effect from foreign exchange rates. In response, a different member said that developments both in foreign exchange rates and stock prices were monetary phenomena, and thus the long-run relationship between money and inflation existed theoretically.

Based on the assessment that the monetary easing implemented so far had brought about improvements in economic activity and price developments mainly through the decline in real interest rates, many members expressed the view that the Bank should place controlling short-term and long-term interest rates at the core of its policy framework, with the aim of realizing such improvements. These members also shared the recognition that QQE with a Negative Interest Rate had had substantial effects in lowering interest rates, and likewise a large impact on financial institutions' profits. On this basis, the members agreed that it was appropriate to take account of developments in economic activity and prices as well as financial conditions, and work toward the formation of the yield curve that was deemed most appropriate for achieving the price stability target by controlling short-term and long-term interest rates. These members noted that, under such policy framework, the Bank would be able to make flexible adjustments according to developments in economic activity and prices and in financial conditions, and that its introduction would also enhance the sustainability of monetary easing. One member said that, if the Bank adopted long-term interest rates as its operating target, it would be able to make more flexible adjustments in the amount of JGB purchases, according to developments in economic activity and prices as well as financial conditions. On this basis, the member continued that, while the amount of the Bank's JGB purchases might fluctuate, either upward or downward, to achieve the target level of a long-term interest rate specified by the guideline for market operations, the Bank should clearly explain that such a change in the amount of purchases would have no policy implication. A different member noted that, in order to control the yield curve, the Bank would continue to purchase large amounts of JGBs, and therefore the monetary base would certainly expand significantly. On this basis, the member said that, if the Bank adopted the interest rate as its operating target, the monthly pace of increase in the monetary base would fluctuate somewhat. The member continued that this, however, was unlikely to affect the formation of inflation expectations.

With regard to the feasibility of controlling short-term and long-term interest rates, many members expressed the view that it was possible to control the yield curve, as it had been confirmed that the combination of the Bank's large-scale purchases of JGBs under QQE and the negative interest rate policy introduced in January 2016 had pushed down the entire yield curve. One member pointed out that the conventional view among central banks had been that they could control short-term rates but not long-term rates. However, the member continued that, since the global financial crisis, central banks in Europe and the United States had added to their monetary policy tools large-scale purchases of government bonds, through which they had placed downward pressure across the entire yield curve. A different member said that it was a fact that the Bank had been able to control long-term interest rates to a certain extent over the past six months, and that if the impact of a given amount of JGB purchases on interest rates were to change depending on circumstances, it was natural that the concept of controlling the yield curve had arisen. In response to these views, one member noted that achieving both an interest rate target and a quantitative target in the implementation of monetary policy was difficult. This member continued that, in the case of a measure taken by the Federal Reserve in the 1940s through the 1950s that had set an upper limit on long-term interest rates, the amount outstanding of its government bond holdings grew substantially over a short period of time, during a phase of heightened inflation risk. Meanwhile, a different member -- noting that the Bank's guideline for market operations was for the intermeeting period -- expressed agreement in principle with a policy framework that would examine an appropriate shape of the yield curve at every Monetary Policy Meeting.

To reflect the above proposals from the members, the staff presented the design of the new policy framework, which consisted of the following.

(1) Yield curve control

(a) The Bank would set a guideline for market operations that specified (1) the short-term policy interest rate to be applied to the Policy-Rate Balances in current accounts held by financial institutions at the Bank and (2) the target level of 10-year JGB yields.

(b) With regard to the amount of JGBs to be purchased, the Bank would conduct purchases aiming to achieve the target level of the long-term interest rate specified by the guideline, while indicating the approximate pace at which it would increase its purchases annually.

(c) JGBs with a wide range of maturities would continue to be eligible for purchase, while the guideline for average remaining maturity of the Bank's JGB purchases would be abolished.

(d) As new tools of market operations to control the yield curve smoothly, the Bank would (1) introduce fixed-rate JGB purchase operations and (2) extend the longest maturity of the fixed-rate funds-supplying operations from one year as at present to a period of up to ten years.

(e) The guideline for the intermeeting period would be as follows, assuming the shape and the locations of the yield curve would broadly remain as they were at present. First, as for the short-term policy interest rate, the Bank would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, the Bank would set the target level of 10-year JGB yields more or less at the current level of around 0 percent. Third, with regard to the amount of JGBs to be purchased, the Bank would conduct purchases more or less in line with the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen.

(2) Inflation-overshooting commitment

The Bank would continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeded the price stability target of 2 percent and stayed above the target in a stable manner.

Many members supported the introduction of QQE with Yield Curve Control, which consisted of the inflation-overshooting commitment and yield curve control. One member noted that the combination of introducing the strong inflation-overshooting commitment and enhancing the flexibility and sustainability of monetary easing through yield curve control was the most effective action that could be taken for now. A different member said that QQE with Yield Curve Control was an effective measure that enabled the Bank to make flexible adjustments as appropriate while maintaining the powerful policy framework of QQE with a Negative Interest Rate. On this basis, the member added that, in order to achieve the price stability target of 2 percent in a stable manner, it was essential that the Bank maintain highly accommodative financial conditions and that both the public and private sectors accelerate implementation of initiatives for strengthening Japan's growth potential.

Moreover, members agreed that the Bank would make <u>policy adjustments as appropriate</u>, taking account of developments in economic activity and prices as well as financial conditions, if judged necessary for maintaining the momentum toward achieving the price stability target of 2 percent. With regard to possible additional easing measures, many members shared the view that the Bank could (1) cut the short-term policy interest rate, (2) cut the target level of a long-term interest rate, (3) expand asset purchases, and (4) if the situation warranted it, accelerate the expansion of the monetary base. One member noted that, if the Bank were to accelerate the expansion of the monetary base, this was highly likely to be accompanied by a considerable decline in interest rates. This member then said that it was necessary for the Bank to conduct monetary policy in a balanced manner with an emphasis on controlling the yield curve, and be prepared to fully mobilize all possible measures should the need arise.

Based on the above discussions, regarding <u>the guideline for market operations for the intermeeting period</u>, many members expressed the view that it was appropriate for the Bank to set the guideline as follows. First, as for the short-term policy interest rate, it would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, as for the long-term interest rate, it would purchase JGBs so that 10-year JGB yields would remain more or less at the current level of around 0 percent. With regard to the amount of JGBs to be purchased, the Bank would conduct purchases more or less in line with the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline. JGBs with a wide range of maturities would continue to be eligible for purchase, while the guideline for average remaining maturity of the Bank's JGB purchases would be abolished.

With regard to asset purchases except for JGB purchases, many members shared the recognition that it was appropriate for the Bank to implement the following guideline for the intermeeting period. First, it would purchase ETFs and Japan real estate investment trusts (J-REITs) so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. Second, as for CP and corporate bonds, it 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 future conduct of monetary policy, many members shared the view that the Bank would (1) continue with QQE with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining that target in a stable manner, (2) continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeded the price stability target of 2 percent and stayed above the target in a stable manner, although the pace of increase in the monetary base might fluctuate in the short run under market operations that aimed at controlling the yield curve, and (3) make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target of 2 percent.

VIII. Remarks by Government Representatives

On the basis of the discussions on the "Comprehensive Assessment" and the introduction of QQE with Yield Curve Control, the government representatives requested that the chairman adjourn the meeting because they needed to contact the Minister of Finance and the Minister of State for Economic and Fiscal Policy. The chairman approved the request. (The meeting adjourned at 11:39 a.m. and reconvened at 12:11 p.m.)

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

(1) The Bank had conducted a comprehensive assessment and a new framework for strengthening monetary easing had been proposed at this meeting. The government recognized that the proposed framework was necessary for achieving the price stability

target of 2 percent at the earliest possible time in order to overcome deflation and achieve sustainable economic growth, and welcomed it.

(2) Overcoming deflation and achieving sustainable economic growth were important policy challenges the government and the Bank shared in common. The government therefore considered it important to continue working closely with the Bank and fully mobilize monetary policy, fiscal policy, and structural reforms.

(3) Based on Economic Measures for Realizing Investment for the Future, which was decided by the Cabinet on August 2, the government would submit a supplementary budget during the extraordinary Diet session, to be held from September 26, and work to promptly obtain the Diet's approval. It also would do its utmost to promote structural reforms, such as steadily advancing working-style reform.

(4) The government continued to expect the Bank to work toward achieving the price stability target in light of developments in economic activity and prices.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on a moderate recovery, while weakness could be seen recently. The second preliminary estimate of the real GDP growth rate for the April-June quarter of 2016 released in September was 0.7 percent on an annualized quarter-on-quarter basis, mainly due to the fact that private consumption, housing investment, and public investment had been positive. As for the outlook, the economy was expected to head toward a moderate recovery, supported partly by the effects of the government's policies, while the employment and income situation continued to improve. In assessing price developments, it was important to comprehensively examine a wide range of indicators, including the GDP deflator.

(2) In order to overcome deflation completely and present a road map for the economy to grow firmly, the Cabinet had decided the Economic Measures for Realizing Investment for the Future and the supplementary budget, which contained concrete plans for these measures. With regard to the working-style reform, the government would aim to compile a concrete action plan within the fiscal year. The government had also set up the Council on Investments for the Future as a new control tower for the growth strategy.

(3) The government welcomed the Bank's "Comprehensive Assessment" as an extensive

analysis on developments in economic activity and prices as well as policy effects since the introduction of QQE, and on the effects and impact of the negative interest rate. The government also welcomed the measures proposed at this meeting -- which were based on the assessment -- as those necessary in order to achieve the price stability target. The government deemed it important that the Bank thoroughly explain to the public the results of the assessment, as well as the measures proposed at this meeting.

(4) The government expected the Bank to steadily work toward achieving the price stability target of 2 percent in light of developments in economic activity and prices.

IX. Votes

A. Vote on the Chairman's Policy Proposal on "Comprehensive Assessment: Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)"

Based on the above discussions, to reflect the majority view of the members, the chairman formulated a proposal on "The Bank's View" in "Comprehensive Assessment: Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)" and put it to a vote.

The Policy Board decided the proposal by a majority vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.
Votes against the proposal: Mr. T. Sato and Mr. T. Kiuchi.

Mr. T. Sato dissented mainly on the following grounds: (1) with regard to the expression that "the relationship between the monetary base and inflation expectations seems to be of a long-run rather than a short-run nature," he was of the view that a long-run relationship between the two was not necessarily clear, and (2) regarding the expression that "measures to strengthen the forward-looking expectation formation mechanism are warranted," he was unsure whether there were any effective measures to strengthen such mechanism. Mr. T. Kiuchi dissented because the comprehensive assessment (1) did not provide analyses on a decline in the sustainability and stability of the Bank's JGB purchases, an increasing risk to the Bank's financial soundness, and the impact of QQE on liquidity and the price-discovery function in financial markets, and (2) differed from his own views regarding price stability, price determination mechanisms and their related policy effects, and the validity of the level of the price stability target and the directions to take on monetary policy toward achieving the target.

B. Vote on the Chairman's Policy Proposal on "Current Situation of and Outlook for Economic Activity and Prices in Japan"

To reflect the majority view of the members, the chairman formulated a proposal on "Current Situation of and Outlook for Economic Activity and Prices in Japan" and put it to a vote.

The Policy Board decided the proposal by a majority vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.
Votes against the proposal: Mr. T. Kiuchi.

Mr. T. Kiuchi opposed the expression that the year-on-year rate of change in the CPI was likely to accelerate toward 2 percent.

C. Vote on the Chairman's Policy Proposal on the Guideline for Market Operations

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

The Policy Board decided the proposal by a majority vote.

The Chairman's Policy Proposal on the Guideline for Market Operations:
The guideline for market operations for the intermeeting period will be as follows.

1. The Bank will apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank.

2. The Bank will purchase JGBs so that 10-year JGB yields will remain more or less at the current level of around 0 percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases more or less in line with the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline. JGBs with a wide range of maturities will continue to be eligible for purchase, while the guideline for average remaining maturity of the Bank's JGB purchases will be abolished.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.
Votes against the proposal: Mr. T. Sato and Mr. T. Kiuchi.

Mr. T. Sato dissented considering that setting the short-term policy rate at minus 0.1 percent and the target level of 10-year JGB yields at around 0 percent could lead to holding JGB yields in negative territory up to a maturity of ten years and thus could have an adverse impact on the functioning of financial intermediation. Mr. T. Kiuchi dissented considering that, with a view to maintaining the stability of the JGB market and the functioning of financial intermediation, (1) the short-term policy interest rate should be set at 0.1 percent and (2) the adoption of a target level of a long-term interest rate was not appropriate because it would entail a risk that the Bank might need to further increase the pace of its JGB purchases.

D. Vote on the Chairman's Policy Proposal on the New Tools of Market Operations for Facilitating Yield Curve Control

To reflect the majority view of the members, the chairman formulated a proposal to introduce the following new tools of market operations so as to control the yield curve smoothly: (1) outright purchases of JGBs with yields designated by the Bank (fixed-rate purchase operations) and (2) fixed-rate funds-supplying operations for a period of up to ten years (extending the longest maturity of the operation from one year as at present). The proposal was then put to a vote.

The Policy Board decided the proposal by a majority vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.
Votes against the proposal: Mr. T. Kiuchi.

Mr. T. Kiuchi dissented because the new tools of market operations could impair the functioning of the JGB market and could distort the pricing mechanism in overall financial markets.

E. Vote on the Chairman's Policy Proposal on the Guideline for Asset Purchases

To reflect the majority view of the members, the chairman formulated the following proposal to implement the guideline for asset purchases for the intermeeting period and put it to a vote: (1) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively, and (2) to maintain the amounts outstanding of CP and corporate bonds at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

The Policy Board decided the proposal by a majority vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.
Votes against the proposal: Mr. T. Sato and Mr. T. Kiuchi.

Mr. T. Sato dissented considering that ETF purchases of about 6 trillion yen annually would be excessive in light of their adverse impact on the pricing mechanism in the stock market and the Bank's financial soundness.

F. Vote on Mr. T. Kiuchi's Policy Proposal on the Guideline for Asset Purchases

Mr. T. Kiuchi proposed that the Bank continue to use amounts of asset purchases as its operating target and that the guideline for asset purchases for the intermeeting period be set as follows: (1) to purchase JGBs so that their amount outstanding would increase at an annual pace of about 45 trillion yen, and to make the average remaining maturity of the Bank's JGB purchases about seven years; (2) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 1 trillion yen and about 30 billion yen, respectively; and (3) to maintain the amounts outstanding of CP and corporate bonds at about 2.2 trillion yen and about 3.2 trillion yen, respectively. 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

X. Discussion on the Statement Entitled "New Framework for Strengthening Monetary Easing: 'Quantitative and Qualitative Monetary Easing with Yield Curve Control'"

On the basis of the above discussions, members discussed the statement "New Framework for Strengthening Monetary Easing: 'Quantitative and Qualitative Monetary Easing with Yield Curve Control'" and formed a majority view. Mr. T. Kiuchi, however, formulated a proposal, and thus two proposals were submitted. Meanwhile, Mr. T. Sato expressed dissent from the "inflation-overshooting commitment" regarding an expansion of the monetary base considering that this was not a realistic target and would not be effective.

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T. Kiuchi formulated a proposal to make the following changes. He proposed deleting section 2.(3) and changing the expression in the second and third sentences of section 4 to a new one that "the Bank will, with the aim to achieve the price stability target of 2 percent in the medium to long term, continue to provide consistent support from the financial side. It will continue with asset purchases and a virtually zero short-term interest rate policy as long as each of these policy measures is deemed appropriate under flexible policy conduct based on the examination from the two perspectives of the monetary policy framework -- that is, (1) the outlook deemed most likely by the Bank and (2) risks that are most relevant to the conduct of monetary policy from a medium- to long-term perspective. The Bank believes that the government's fiscal policy, initiatives for strengthening Japan's growth potential, and the Bank's monetary easing will produce effects that will navigate Japan's economy toward achieving sustainable growth." 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

B. The Chairman's Policy Proposal

The chairman formulated the statement "New Framework for Strengthening Monetary Easing: 'Quantitative and Qualitative Monetary Easing with Yield Curve Control'" 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 1).

Attachment 1
September 21, 2016
Bank of Japan

New Framework for Strengthening Monetary Easing:
"Quantitative and Qualitative Monetary Easing with Yield Curve Control"

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan conducted a comprehensive assessment of the developments in economic activity and prices under "Quantitative and Qualitative Monetary Easing (QQE)" and "QQE with a Negative Interest Rate" as well as their policy effects, and compiled "The Bank's View" as provided in Attachment 2. The Policy Board's view on the current situation of and outlook for economic activity and prices is provided in Attachment 3.

2. Based on these, with a view to achieving the price stability target of 2 percent at the earliest possible time, the Bank decided to introduce "QQE with Yield Curve Control" by strengthening the two previous policy frameworks mentioned above. The new policy framework consists of two major components: the first is "yield curve control" in which the Bank will control short-term and long-term interest rates; and the second is an "inflation-overshooting commitment" in which the Bank commits itself to expanding the monetary base until the year-on-year rate of increase in the observed consumer price index (CPI) exceeds the price stability target of 2 percent and stays above the target in a stable manner. Specifically, the Bank decided upon the following.

   (1) Yield curve control

      a) Guideline for market operations (by a 7-2 majority vote)[Note 1]

      The guideline for market operations specifies a short-term policy interest rate and a target level of a long-term interest rate. The Bank decided to set the following guideline for market operations for the intermeeting period. The Bank will cut the interest rates further if judged necessary.

      The short-term policy interest rate:
      The Bank will apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank.

The long-term interest rate:

The Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain more or less at the current level (around zero percent). With regard to the amount of JGBs to be purchased, the Bank will conduct purchases more or less in line with the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings at about 80 trillion yen -- aiming to achieve the target level of a long-term interest rate specified by the guideline. JGBs with a wide range of maturities will continue to be eligible for purchase, while the guideline for average remaining maturity of the Bank's JGB purchases will be abolished.

b) New tools of market operations for facilitating yield curve control (by an 8-1 majority vote)[Note 2]

The Bank decided to introduce the following new tools of market operations so as to control the yield curve smoothly.

(i) Outright purchases of JGBs with yields designated by the Bank (fixed-rate purchase operations)[9]

(ii) Fixed-rate funds-supplying operations for a period of up to 10 years (extending the longest maturity of the operation from 1 year at present)

(2) Guidelines for asset purchases

With regard to asset purchases except for JGB purchases, the Bank decided, by a 7-2 majority vote, to set the following guidelines.[Note 3]

a) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively.

b) 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.

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[9] In case of a spike in interest rates, the Bank stands ready to conduct fixed-rate JGB purchase operations -- for example, those with regard to 10-year and 20-year JGB yields -- in order to prevent the yield curve from deviating substantially from the current levels.

(3) Inflation-overshooting commitment[Note 4]

The Bank will continue with "QQE with Yield Curve Control," aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner.

The Bank will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds the price stability target of 2 percent and stays above the target in a stable manner. Meanwhile, the pace of increase in the monetary base may fluctuate in the short run under market operations which aim at controlling the yield curve. With the Bank maintaining this stance, the ratio of the monetary base to nominal GDP in Japan is expected to exceed 100 percent (about 500 trillion yen) in slightly over one year (at present, about 80 percent in Japan compared with about 20 percent in the United States and the euro area).

The Bank will make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target of 2 percent.

3. In light of the findings of the comprehensive assessment, the thinking behind the newly introduced policy framework is as follows.

(1) Background to the introduction of yield curve control

As shown in the comprehensive assessment, QQE has brought about improvements in economic activity and prices mainly through the decline in real interest rates, and Japan's economy is no longer in deflation, which is commonly defined as a sustained decline in prices. With this in mind, "yield curve control," in which the Bank will seek for the decline in real interest rates by controlling short-term and long-term interest rates, would be placed at the core of the new policy framework.

The experience so far with the negative interest rate policy shows that a combination of the negative interest rate on current account balances at the Bank and JGB purchases is effective for yield curve control. In addition, the Bank decided to introduce new tools of market operations which will facilitate smooth implementation of yield curve control.

(2) Measures to raise inflation expectations

The price stability target of 2 percent has not been achieved. In the course of the Bank's attempt to raise inflation expectations toward 2 percent, observed inflation rates declined due to a variety of exogenous factors such as a fall in crude oil prices. Under these circumstances, inflation expectations declined, as the adaptive mechanism has been playing a relatively large role in the formation of inflation expectations in Japan. This seems to be the main factor that hampers achieving the price stability target of 2 percent.

In order to address this situation, the Bank judged it necessary to adopt measures that will raise inflation expectations in a more forceful manner.

First, the Bank decided to adopt a commitment that allows inflation to overshoot the price stability target so as to strengthen the "forward-looking mechanism" in the formation of inflation expectations. Achieving the price stability target means attaining a situation where the inflation rate is 2 percent on average over the business cycle. Given the fact that both observed and expected inflation rates are below 2 percent currently, the Bank judged it appropriate to enhance the credibility for the price stability target among the public by committing itself to "expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeds the price stability target of 2 percent and stays above the target in a stable manner."

Second, it is necessary to have momentum in order to shift peoples' deflationary mindset which had been entrenched amid the prolonged period of deflation. Thus, the Bank adheres to its commitment to achieving the 2 percent inflation "at the earliest possible time." Meanwhile, a further rise in inflation expectations through the adaptive mechanism is uncertain and may take time. Considering these, the Bank judged it appropriate to adopt a new policy framework with the mechanisms for yield curve control placed at the core that enables the Bank to make more flexible adjustments according to developments in economic activity and prices as well as financial conditions and that enhances the sustainability of monetary easing.

(3) Possible options for additional easing

With regard to possible options for additional easing, the Bank can cut the short-term policy interest rate and the target level of a long-term interest rate, which are two key benchmark rates for yield curve control. It is also possible for the Bank to expand asset purchases as has been the case since the introduction of QQE. Moreover, if the situation warrants it, an acceleration of expansion of the monetary base may also be an option.

4. In January 2013, the Government and the Bank released the joint statement, which sets out that both parties strengthen their policy coordination and work together in order to overcome deflation early and achieve sustainable economic growth with price stability. The Bank will pursue "QQE with Yield Curve Control" and achieve the price stability target of 2 percent at the earliest possible time. The Bank believes that its monetary policy and the Government's fiscal policy as well as initiatives for strengthening Japan's growth potential will produce synergy effects, and thereby will navigate Japan's economy toward overcoming deflation and achieving sustainable growth.[Note 4]

[Note 1] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the action: Mr. T. Sato and Mr. T. Kiuchi. Mr. T. Sato dissented considering that setting the short-term policy rate at minus 0.1 percent and the target level of 10-year JGB yields at around 0 percent could lead to holding JGB yields in negative territory up to a maturity of 10 years and thus could have an adverse impact on the functioning of financial intermediation. Mr. T. Kiuchi dissented considering that, with a view to maintaining the stability of the JGB market and the functioning of financial intermediation, (1) the short-term policy interest rate should be set at 0.1 percent and (2) the adoption of a target level of a long-term interest rate was not appropriate because it would entail a risk that the Bank might need to further increase a pace of its JGB purchases.

[Note 2] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the action: Mr. T. Kiuchi. Mr. T. Kiuchi dissented because the new tools of market operations could impair the functioning of the JGB market and could distort the pricing mechanism in overall financial markets.

[Note 3] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the action: Mr. T. Sato and Mr. T. Kiuchi. Mr. T. Sato dissented considering that ETF purchases of about 6 trillion yen annually would be excessive in light of their adverse impact on the pricing mechanism in the stock market and the Bank's financial soundness. Mr. T. Kiuchi proposed that the Bank continue to use amounts of asset purchases as its operating targets and set the guidelines for asset purchases in which the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 45 trillion yen, purchase ETFs so that their amount outstanding would increase at an annual pace of about 1 trillion yen, and so on. The proposal was defeated by a majority vote.

[Note 4] Mr. T. Sato opposed the "inflation-overshooting commitment" regarding an expansion of the monetary base considering that this was not a realistic target and would not be effective. Mr. T. Kiuchi proposed that Section 2.(3) be deleted and that the Bank aim at achieving the price stability target of 2 percent in the medium to long term in its future conduct of monetary policy. 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

Attachment 2

Comprehensive Assessment:
Developments in Economic Activity and Prices as well as Policy Effects since the Introduction of Quantitative and Qualitative Monetary Easing (QQE)

The Bank's View[Note 5]

I. Comprehensive Assessment

A. Transmission Mechanism of QQE

QQE has lowered real interest rates by raising inflation expectations and pushing down nominal interest rates. Although the natural rate of interest has followed a downward trend, real interest rates have been well below the natural rate of interest, leading to an improvement in financial conditions. As a result, economic activity and price developments improved, and Japan's economy is no longer in deflation, which is commonly defined as a sustained decline in prices.

B. Factors That Have Hampered Achieving the 2 Percent Price Stability Target

However, the price stability target of 2 percent has not been achieved. In terms of the mechanism described above, this is largely due to developments in inflation expectations. The following two factors have played a role in the development of inflation expectations. First, exogenous developments, including (1) the decline in crude oil prices, (2) the weakness in demand following the consumption tax hike in April 2014, and (3) the slowdown in emerging economies and volatile global financial markets, have lowered the observed inflation rate. And second, amid this decline in the observed inflation rate, inflation expectations -- after having been largely flat -- weakened, reflecting the fact that expectations formation in Japan is largely adaptive, that is, backward-looking.

C. The Mechanism of Inflation Expectations Formation

Inflation expectations need to be raised further in order to achieve the price stability target of 2 percent. However, it should be noted that, since the observed inflation rate is likely to remain subdued for the time being, a further rise in inflation expectations through the adaptive mechanism is uncertain and may take time. This highlights the important role played by the forward-looking expectations formation mechanism.

The expansion of the monetary base, together with the commitment to achieving the price stability target and the Bank's purchases of Japanese government bonds (JGBs), by bringing about a regime change in monetary policy, has transformed peoples' perceptions of inflation and has led to a rise in inflation expectations. The relationship between the monetary base and inflation expectations seems to be of a long-run rather than a short-run nature. Therefore, what is important is the Bank's commitment to expanding the monetary base in the long run.

D. Pushing Down the Yield Curve through the Negative Interest Rate and JGB Purchases

The negative interest rate policy introduced by the Bank in January 2016, in combination with JGB purchases, has pushed down not only short-term but also long-term interest rates substantially. This shows that the combination of these policy measures is an effective means for the central bank to exert influence on the entire yield curve.

E. The Effects and Impact of the Decline in the Yield Curve

The decline in JGB yields has translated into a decline in lending rates as well as interest rates on corporate bonds and CP. Financial institutions' lending attitudes continue to be proactive. Thus, so far, financial conditions have become more accommodative under the negative interest rate policy. However, because the decline in lending rates has been brought about by reducing financial institutions' lending margins, the extent to which a further decline in the yield curve will lead to a decline in lending rates depends on financial institutions' lending stance going forward.

The impact of interest rates on economic activity and prices as well as financial conditions depends on the shape of the yield curve. In this regard, the following three points warrant attention. First, short- and medium-term interest rates have a larger impact on economic activity than longer-term rates. Second, the link between the impact of interest rates and the shape of the yield curve may change as firms explore new ways of raising funds such as issuing super-long-term corporate bonds under the current monetary easing, including the negative interest rate policy. Third, an excessive decline and flattening of the yield curve may have a negative impact on economic activity by leading to a deterioration in people's sentiment, as it can cause uncertainty about the sustainability of financial functioning in a broader sense.

II. Directions for Monetary Policy Suggested by the Comprehensive Assessment

These findings of the comprehensive assessment suggest the following directions for monetary policy.

(1) Inflation expectations need to be raised further in order to achieve the price stability target of 2 percent. Given that a further rise in inflation expectations through the adaptive mechanism is uncertain and may take time, measures to strengthen the forward-looking expectations formation mechanism are warranted. At the same time, the Bank needs to adopt measures that enable the Bank to make flexible adjustments according to developments in economic activity and prices as well as financial conditions and that enhances the sustainability of monetary easing.

(2) The Bank should commit itself to expanding the monetary base in the long run.

(3) The Bank can exert influence on interest rates along the entire yield curve through the appropriate combination of a negative interest rate and JGB purchases.

(4) To work toward the formation of an appropriate yield curve, the Bank should take account of economic, price, and financial conditions, including (i) the extent to which a decline in JGB yields translates into a decline in lending and corporate bond rates, (ii) the effects of a decline in JGB yields on economic activity, and (iii) the impact of a decline in JGB yields on financial functioning.

[Note 5] Voting for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the proposal: Mr. T. Sato and Mr. T. Kiuchi. Mr. T. Sato opposed the expressions such as "the relationship between the monetary base and inflation expectations seems to be of a long-run rather than a short-run nature." Mr. T. Kiuchi dissented because the comprehensive assessment (1) did not examine a decline in sustainability of the Bank's JGB purchases and an increasing risk to the Bank's financial soundness and (2) differed from his own view regarding price determination mechanisms and achievement of the price stability target.

Attachment 3

Current Situation of and Outlook for Economic Activity and Prices in Japan

1. Japan's economy has continued its moderate recovery trend, although exports and production have been sluggish due mainly to the effects of the slowdown in emerging economies. Overseas economies have continued to grow at a moderate pace, but the pace of growth has somewhat decelerated mainly in emerging economies. In this situation, exports have been more or less flat. On the domestic demand side, business fixed investment has been on a moderate increasing trend as corporate profits have been at high levels. Against the background of steady improvement in the employment and income situation, private consumption has been resilient, although relatively weak developments have been seen in some indicators. Housing investment has continued picking up, and the decline in public investment has leveled off. Reflecting these developments in demand both at home and abroad, industrial production has continued to be more or less flat. Financial conditions are highly accommodative. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) has been slightly negative. Although inflation expectations appear to be rising on the whole from a somewhat longer-term perspective, they have recently weakened.

2. With regard to the outlook, sluggishness is expected to remain in exports and production for some time, and the pace of economic recovery is likely to remain slow. Thereafter, domestic demand is likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the household and corporate sectors, and exports are expected to head toward a moderate increase as overseas economies move out of their deceleration phase. Thus, Japan's economy is likely to be on a moderate expanding trend. The year-on-year rate of change in the CPI is likely to be slightly negative or about 0 percent for the time being, due to the effects of the decline in energy prices, and, as the underlying trend in inflation steadily rises, accelerate toward 2 percent.[Note 6]

3. Risks to the outlook include the impact that uncertainties associated with the United Kingdom's vote to leave the European Union would have on the global financial markets and global economy, uncertainties surrounding emerging and commodity-exporting economies, particularly China, developments in the U.S. economy and the impact of its monetary policy on global financial markets, prospects regarding the European debt problem -- including the

financial sector -- and the momentum of economic activity and prices in Europe, and geopolitical risks.

[Note 6] Voting for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the proposal: Mr. T. Kiuchi. Mr. T. Kiuchi opposed the expression that the year-on-year rate of change in the CPI was likely to accelerate toward 2 percent.