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September 26, 2017

Bank of Japan

Minutes of the Monetary Policy Meeting

on July 19 and 20, 2017

(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 Wednesday, July 19, 2017, from 2:00 p.m. to 3:32 p.m., and on Thursday, July 20, from 9:00 a.m. to 12:03 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. T. Kabe, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

Mr. T. Ochi, State Minister of Cabinet Office, Cabinet Office[2]

Mr. M. Maekawa, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. S. Kuwabara, Executive Director

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

Mr. T. Kato, 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 September 20 and 21, 2017 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 July 20.

[3] Messrs. T. Kabe and M. Maekawa were present on July 19.

Mr. A. Okuno, Head of Policy Planning Division, Monetary Affairs Department

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

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

Mr. H. Ichiue, Head of Economic Research Division, Research and Statistics Department

Mr. Y. Nakata, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. Y. Onozawa, Director-General, Secretariat of the Policy Board

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

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

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

Mr. J. Ide, 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 short-term policy interest rate of minus 0.1 percent and the target level of the long-term interest rate, both decided at the previous meeting on June 15 and 16, 2017, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, 10-year JGB yields had been at around 0 percent, and the shape of the JGB yield curve had been consistent with the guideline for market operations. Meanwhile, with regard to JGB purchases, the Bank, on July 7, conducted outright purchases of long-term JGBs through the fixed-rate method (fixed-rate purchase operations).

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 0.04 to minus 0.06 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had been at around minus 0.1 percent.

The Nikkei 225 Stock Average had been moving at around 20,000 yen in a situation where the yen had been depreciating. In the foreign exchange market, the yen had been depreciating against the U.S. dollar, reflecting the widening interest rate differential between Japan and the United States. Meanwhile, it had been depreciating against the euro, mainly due to speculation about a reduction in monetary accommodation by the European Central Bank (ECB).

C. Overseas Economic and Financial Developments

Overseas economies continued to grow at a moderate pace on the whole.

The U.S. economy continued to recover firmly, mainly in household spending, owing to a steady improvement in the employment and income situation. Exports had been on a pick-up trend, while business fixed investment also continued to pick up. As for prices,

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

[5] The target level of the long-term interest rate was as follows:

The Bank will purchase JGBs so that 10-year JGB yields will remain at around zero percent.

both the year-on-year rate of increase in the personal consumption expenditure (PCE) deflator for all items and that for all items excluding food and energy had been at around 1.5 percent.

The European economy continued to recover steadily, albeit at a moderate pace, mainly in the household sector. Exports continued to pick up. Private consumption had been increasing, partly supported by improvements in the labor market and consumer sentiment, while business fixed investment also had recovered. With regard to prices, the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items excluding energy and unprocessed food had been in the range of 1.0-1.5 percent, and that for all items had been at around 1.5 percent. Meanwhile, economic activity in the United Kingdom generally continued to recover, although the recent rise in prices had been weighing on private consumption.

With regard to emerging economies, the Chinese economy continued to see stable growth on the whole, partly due to the effects of authorities' measures to support economic activity. In the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports continuing to pick up. Economic activity in Russia and Brazil had picked up, mainly due to a bottoming out of commodity prices and the past monetary easing measures. In India, an upheaval in the economy stemming from the abolition of high denomination banknotes had come to a halt, and the economy had been heading toward recovery. As for prices in emerging economies, inflation rates had been more or less flat in many countries and regions.

With respect to overseas financial markets, U.S. and European long-term interest rates had risen, mainly due to speculation about a reduction in monetary accommodation by the ECB. Meanwhile, stock prices had been at high levels in many countries mainly against the backdrop of solid economic indicators and corporate results, and capital inflows to emerging economies continued.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy was expanding moderately, with a virtuous cycle from income to spending operating.

Exports had been on an increasing trend on the back of a pick-up in emerging economies. Those to advanced economies continued on their increasing trend; those to emerging economies had picked up, led mainly by electronic parts and capital goods to Asia. Exports would likely continue their increasing trend for the time being, as those of capital goods and IT-related goods were likely to be firm. Thereafter, they were expected to continue on a moderate increasing trend, with the growth in overseas economies continuing.

Public investment had been turning toward an increase. It was likely to increase for the time being as the effects resulting from the set of stimulus measures gradually took hold. Thereafter, it was expected to start declining as the positive effects resulting from the set of stimulus measures diminished, and then remain more or less flat at a high level underpinned by Olympic Games-related construction.

Business fixed investment had been on a moderate increasing trend with corporate profits improving. According to the June 2017 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), business fixed investment plans for fiscal 2017, especially those of large firms, showed firms' solid stance. Reflecting this positive stance, machinery orders and construction starts in terms of planned expenses for private and nondwelling construction -- both of which were leading indicators of business fixed investment -- continued on an increasing trend, albeit with large monthly fluctuations. Business fixed investment was likely to continue increasing moderately for the time being, mainly on the back of an improvement in corporate profits, accommodative financial conditions, and heightened growth expectations. Thereafter, particularly with cyclical adjustments in capital stock becoming evident, downward pressure on business fixed investment was expected to intensify.

As for the employment and income situation, supply-demand conditions in the labor market continued to tighten steadily and employee income had increased moderately. The active job openings-to-applicants ratio had followed a steady improving trend. The unemployment rate continued on a moderate declining trend.

Private consumption had increased its resilience against the background of steady improvement in the employment and income situation. The consumption activity index (CAI) -- calculated by combining various sales and supply-side statistics -- for the January-March quarter of 2017 had marked a fourth consecutive quarterly increase, and that for the April-May period continued to increase at an accelerated pace relative to the

January-March quarter. Private consumption was expected to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as replacement demand for durable goods.

Housing investment had been more or less flat.

Industrial production had been on an increasing trend against the background of increases in demand at home and abroad. It was likely to continue to increase firmly for the time being on the back of the increases in demand at home and abroad. Thereafter, it was projected to continue on a moderate increasing trend, mainly reflecting the recovery in emerging economies and the effects resulting from the set of stimulus measures materializing.

As for prices, the pace of increase in the producer price index (PPI) compared with three months earlier had been slowing down, 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 was in the range of 0.0-0.5 percent. The rate of change for all items less fresh food and energy had been at around 0 percent. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations.

2. Financial environment

Financial conditions were highly accommodative.

Inflation expectations remained in a weakening phase. Real long-term interest rates -- calculated as long-term interest rates minus medium- to long-term inflation expectations -- had been negative.

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, such as for funds related to mergers and acquisitions, as well as for those for business fixed investment. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had accelerated at a moderate pace to the range of 3.0-3.5 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds also had accelerated recently. Firms' financial positions had been favorable.

The monetary base had been increasing at a high year-on-year growth rate of around 20 percent. The year-on-year rate of growth in the money stock had been at around 4 percent.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments and the July 2017 *Outlook for Economic Activity and Prices*

A. Economic Developments

Regarding global financial markets, members shared the recognition that, since late June, U.S. and European long-term interest rates had risen, mainly due to speculation about a reduction in monetary accommodation by the ECB and the Bank of England. They also shared the view that, despite the rise in long-term interest rates, investors had generally maintained their risk-taking stance, as stock prices had been at high levels in many countries mainly against the backdrop of solid economic indicators and corporate results, and capital inflows to emerging economies continued. As for developments in global financial markets going forward, some members said that particular attention should be paid to the effects, such as of developments in monetary policies in the United States and Europe, on each country's bond and stock markets as well as the global flow of funds.

With respect to overseas economies, members agreed that, as the global recovery in trade activity and the manufacturing sector continued, advanced economies continued to recover steadily and emerging economies had picked up on the whole. On this basis, they shared the recognition that overseas economies continued to grow at a moderate pace on the whole. As for the outlook, members concurred that the growth rates of overseas economies were likely to increase moderately as advanced economies continued growing steadily and the recovery in emerging economies took hold on the back of the steady growth in advanced economies and the effects of policy measures taken by emerging economies.

With regard to developments in overseas economies by region, members concurred that the U.S. economy continued to recover firmly, mainly in household spending, amid a steady improvement in the employment and income situation, as seen, for example, in a firm increase in the number of employees for the April-June quarter of 2017. One member noted that, despite the policy rate hikes by the Federal Reserve since December

2016, no remarkable changes in economic sentiment had been observed so far. As for the outlook, members shared the view that the economy was likely to continue to see firm growth driven by domestic private demand. However, some members said that attention should be paid to future developments in private consumption, while pointing out that motor vehicle sales for the April-June quarter of 2017 represented a second consecutive quarterly decrease.

Members shared the recognition that the European economy continued to recover steadily, albeit at a moderate pace, mainly in the household sector. One member pointed out that various confidence indicators, such as those of consumer sentiment, continued on an improving trend, partly due to the progress in addressing the nonperforming loan problems of the banking sector and the waning political risks, in addition to the recovery in economic activity. As for the outlook, members concurred that the economy would likely follow a moderate recovery trend, while uncertainty -- associated with political issues, such as those regarding negotiations on the United Kingdom's exit from the European Union (EU), and with the European debt problem, including in the financial sector -- was likely to weigh on economic activity.

Members shared the recognition that emerging economies had picked up on the whole. Of these economies, most members shared the view that the Chinese economy continued to see stable growth on the whole, as seen, for example, in the fact that exports had picked up markedly, fixed asset investment -- public investment in particular -- had increased, and private consumption had been resilient. One member added that the June 2017 results for the Purchasing Managers' Index (PMI) for manufacturing activity and retail sales as well as the GDP growth rate for the April-June quarter were all firm, and that this was encouraging for the global economy for the time being. In the NIEs and the ASEAN countries, members concurred that domestic demand had been resilient, particularly reflecting improvements in business and household sentiment and the effects of economic stimulus measures, with exports picking up as a trend. As for the outlook, they agreed that emerging economies were likely to see gradual increases in their growth rates, due mainly to the effects of the economic stimulus measures and the spread of the effects of steady growth in advanced economies. Members shared the view that the Chinese economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policy in a timely manner.

Members concurred that financial conditions in Japan were highly accommodative. They shared the view that, under Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, firms' funding costs had been hovering at extremely low levels. One member added that such accommodative financial conditions continued to strongly support corporate activity in Japan.

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

With regard to economic activity, members shared the view that, with corporate profits improving, which mainly reflected the growth in overseas economies, business fixed investment plans were becoming solid on the whole. They also shared the recognition that the employment and income situation had improved steadily and private consumption had increased its resilience. Members then concurred that a positive output gap had taken hold, given the recent tightening of labor market conditions and the increase in capacity utilization rates, with the latter reflecting a rise in production. Based on this discussion, they agreed to revise the Bank's economic assessment upward to one stating that Japan's economy "is expanding moderately, with a virtuous cycle from income to spending operating" from the previous one stating that the economy "has been turning toward a moderate expansion." One member pointed out that Japan's economy was shifting from a recovery dependent on external demand to a more self-sustaining expansion brought about by an improvement in domestic demand. This member continued that it was also becoming evident that improvements in economic activity had been spreading across a wider range of areas, urban to regional.

Members shared the recognition that exports had been on an increasing trend on the back of a pick-up in emerging economies. As for the outlook, they agreed that exports would likely continue their increasing trend for the time being with global production and trade activity of the manufacturing sector remaining at favorable levels. They continued that, thereafter, exports were likely to continue increasing moderately on the back of the growth in overseas economies, albeit with fluctuations resulting mainly from the subsequent decline in IT-related demand following the current increase.

As for public investment, a few members pointed out that orders based on the second supplementary budget for fiscal 2016 had started to become noticeable, as seen, for example, in a significant increase in the amount of public construction completed for April

2017. On this basis, members agreed that it was appropriate to revise the Bank's assessment upward to one stating that public investment "has been turning toward an increase" from the previous one stating that it "has been more or less flat."

Members shared the recognition that business fixed investment had been on a moderate increasing trend. Some members pointed out that the ratio of current profits to sales for all industries and enterprises had marked a record high level for two consecutive quarters, in the October-December quarter of 2016 and the January-March quarter of 2017, and that the diffusion index for business conditions for all industries and enterprises (the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable") in the June 2017 *Tankan* had improved for four consecutive quarters. These members then said that corporate profits and business sentiment had improved, and across a wider range of industries, and that this had supported the increase in business fixed investment. Regarding the outlook, members agreed that business fixed investment was likely to continue increasing moderately, mainly on the back of accommodative financial conditions and heightened growth expectations.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to tighten steadily and employee income had increased moderately. On this point, some members noted that wages of part-time employees -- which were sensitive to labor market conditions -- had clearly improved. With regard to the outlook, members shared the view that employee income was likely to continue to increase moderately as labor market conditions kept tightening steadily and corporate profits improved. One member said that the active job openings-to-applicants ratio for regular employees -- which had been lower than that for part-time employees -- was approaching 1.0 recently. The member continued that this showed potential for further improvement in the employment and income situation.

Members shared the recognition that private consumption had increased its resilience against the background of steady improvement in the employment and income situation. A few members said that private consumption was slightly gaining momentum recently, as suggested by, for example, the fact that the CAI -- after having increased for four consecutive quarters since the April-June quarter of 2016 -- had increased further recently. In the outlook, members shared the view that private consumption was likely to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as replacement demand for durable goods.

Members shared the recognition that housing investment had been more or less flat.

Members shared the view that industrial production had been on an increasing trend against the background of increases in demand at home and abroad. Regarding the outlook, they agreed that industrial production was likely to continue to increase firmly for the time being on the back of the increases in demand at home and abroad, and thereafter continue on a moderate increasing trend, mainly reflecting a rise in the growth rates of emerging economies.

As for prices, members shared the recognition that the year-on-year rate of change in the CPI (all items less fresh food) was in the range of 0.0-0.5 percent, and that the rate of change for all items less fresh food and energy had been at around 0 percent, partly due to limited price rises at the start of the new fiscal year. On this point, many members expressed the view that prices had been relatively weak despite the steady tightening of labor market conditions amid the moderate expansion of the economy. Meanwhile, members shared the recognition that inflation expectations remained in a weakening phase. Some members, however, pointed out that some indicators showed a rise in such expectations recently, as suggested by the results of some surveys conducted on firms and households.

B. Outlook for Economic Activity and Prices

In formulating the July 2017 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), with regard to the baseline scenario of the outlook for Japan's economic activity, members shared the view that the economy was likely to continue its moderate expansion. They shared the recognition that, through fiscal 2018, domestic demand was likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, on the back of highly accommodative financial conditions and fiscal spending through the government's large-scale stimulus measures. Members also agreed that exports were likely to continue their moderate increasing trend as the growth rates of overseas economies were likely to increase moderately. They shared the recognition that, in fiscal 2019, the economy was likely to continue expanding, supported by external demand, although the growth pace would probably decelerate due to a slowdown in domestic demand. Most members then expressed the view that Japan's economy was likely to continue growing at a pace above its potential, mainly through fiscal 2018. These members agreed that the growth rates for the projection period of fiscal 2017-2019 were somewhat higher than those presented in the April 2017 Outlook Report.

As for economic activity through fiscal 2018, members shared the view that business fixed investment was likely to continue increasing moderately, supported by accommodative financial conditions, heightened growth expectations, and increases in Olympic Games-related investment, as well as in labor-saving investment to address the labor shortage. They also agreed that private consumption was likely to follow a moderate increasing trend as the employment and income situation continued to improve, and that public investment was likely to increase through fiscal 2017, due mainly to the positive effects resulting from the set of stimulus measures, and thereafter remain at a relatively high level. Regarding fiscal 2019, members concurred that business fixed investment was likely to decelerate, mainly reflecting cyclical adjustments in capital stock after the prolonged economic expansion, as well as Olympic Games-related demand peaking out, and that private consumption was likely to turn to a decline in the second half of the fiscal year due to the effects of the scheduled consumption tax hike. They then shared the view that the increase in exports on the back of the growth in overseas economies was likely to underpin the economy. Members shared the recognition that, although the effects of the scheduled consumption tax hike on economic activity were likely to be smaller than those in fiscal 2014, when the last consumption tax hike took place, they were highly uncertain and varied depending, for example, on the income situation and price developments.

In relation to the effects of economic activity on prices, members focused in their discussion on the point that prices had been relatively weak despite the steady tightening of labor market conditions. As background to this, they shared the view that firms had been making efforts to absorb a rise in labor costs by increasing labor-saving investment that took advantage of IT and by taking measures such as a streamlining of the existing business process -- for example, discontinuation of business late at night and early in the morning -- while limiting wage increases that corresponded to the labor shortage, mainly to wages of part-time employees. On the point that firms' wage- and price-setting stance remained cautious, as suggested by these developments, many members noted that this was attributable to the fact that the mindset and behavior based on the assumption that wages and prices would not increase easily had been deeply entrenched among firms and households. One of these members added that firms' cautious price-setting stance had been brought about also by the weak recovery in consumption after the consumption tax hike in 2014.

Based on the above discussion, many members shared the view that, given that there naturally seemed to be a limit to firms' ability to absorb labor costs amid the continued tightening of labor market conditions, firms were likely to gradually shift their stance toward raising wages and prices. A few members said that, although labor market conditions had been tightening steadily, the unemployment rate and the output gap had not reached the levels seen during the bubble period. These members continued that, in order to achieve the price stability target of 2 percent, it was important that these indicators improve further. One member pointed out that Japanese firms in the services sector, which faced large disparities in labor productivity with U.S. firms, still had considerable room for a further increase in such productivity through a streamlining of their business process; therefore, it would take time before the tightening of labor market conditions led to rises in wages and prices. In response, a different member noted that it was highly possible that Japanese firms' price-setting stance would change even before they could reduce disparities in labor productivity with U.S. and European firms. Another member pointed out that Japanese firms -- which had been adaptive to the deflationary environment for a long time -- had no choice but to transform their business models to ensure survival, with labor shortage becoming more acute. This member then expressed the view that the conditions for a change in the social norm were being put in place toward a rise in prices.

Some members noted that, although measures such as labor-saving investment and a streamlining of firms' business process led to restraining price rises in the short run, such measures should be considered positively as they were the outcome of individual firms' reasonable decision-making so as to avoid a situation where their businesses were constrained by labor shortage. A few members then said that, if these efforts improved labor productivity of the economy as a whole and raised the long-term growth potential, a channel in which demand would be pushed up through rises in growth expectations and permanent income, thereby exerting upward pressure on prices, would be expected to operate.

Moreover, some members referred to the importance of the government's initiatives in order for firms to shift their stance toward raising wages and prices. One of these members said that, to further improve the output gap, not only monetary policy, but also government measures such as demand-creating structural reform would play a large role. A different member pointed to the importance of implementing structural policies that would raise growth expectations, since low growth expectations were a major factor that made firms that faced labor shortage prioritize cost reductions and thereby avoid raising prices.

Based on the above discussion, members exchanged views regarding the outlook for prices. Most members shared the view that, although the recent developments in the CPI had been relatively weak, the year-on-year rate of change was likely to continue on an uptrend and increase toward 2 percent, mainly on the back of the improvement in the output gap and the rise in medium- to long-term inflation expectations. These members agreed that, comparing the current projections with those presented in the April Outlook Report, although the projected rates of increase in the CPI were lower mainly for the first half of the projection period, a virtuous cycle between a moderate rise in the inflation rate and wage increases was likely to start operating gradually toward the end of the projection period -- that is, toward fiscal 2019. On this basis, they shared the recognition that the timing of the year-on-year rate of change in the CPI reaching around 2 percent would likely be around fiscal 2019. Meanwhile, a few members expressed the view that the rate of change would not reach around 2 percent during the projection period.

Members discussed in detail the mechanism through which the virtuous cycle of wages and prices would operate. First, they agreed that the output gap had improved steadily with the tightening of labor market conditions becoming even more evident, as seen, for example, in the active job openings-to-applicants ratio exceeding the peak level observed during the bubble period. Most members shared the recognition that, going forward, as the economy continued its moderate expansion, the output gap was likely to widen further within positive territory through fiscal 2018 and remain substantially positive in fiscal 2019. Next, most members shared the recognition that medium- to long-term inflation expectations were likely to follow an increasing trend and gradually converge to around 2 percent on the back of the following: (1) in terms of the adaptive component, developments mainly in import prices were likely to push up the observed inflation rate for the time being, and firms' stance was likely to gradually shift toward raising wages and prices thereafter with the improvement in the output gap, and (2) in terms of the forward-looking component, the Bank would pursue monetary easing through its strong commitment to achieving the price stability target.

Members also discussed upside and downside risk factors to the baseline scenario of the outlook for economic activity and prices. Regarding the outlook for economic activity, they noted the following three upside and downside risk factors: (1) developments in overseas economies; (2) firms' and households' medium- to long-term growth expectations; and (3) fiscal sustainability in the medium to long term. As upside and downside risks to prices, members pointed to the following three factors: (1) developments in firms' and households' medium- to long-term inflation expectations; (2) the fact that there were items for which prices were not particularly responsive to the output gap; and (3) developments in foreign exchange rates and international commodity prices going forward. On this basis, they shared the recognition that risks to Japan's economic activity and prices were skewed to the downside, especially those concerning developments in overseas economies and in medium- to long-term inflation expectations. Members concurred that, with regard to the latter, there was a risk that a rise in inflation expectations would lag further behind if it took time for firms' stance to shift toward raising wages and prices and inflation consequently remained relatively sluggish.

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.

With regard to conducting monetary policy, most members shared the recognition that, although it was necessary to carefully examine the fact that firms' wage- and price-setting stance remained cautious, the momentum toward achieving the 2 percent price stability target was being maintained. As background to this, many members noted the following two points: (1) firms' stance was likely to gradually shift toward raising wages and prices with the steady improvement in the output gap, and (2) while indicators of medium- to long-term inflation expectations had stopped declining and some of them were showing a rise, such expectations were likely to rise steadily as further price rises came to be observed widely. Following this discussion, many members shared the recognition that it was appropriate for the Bank to pursue powerful monetary easing with persistence under the current guideline for market operations. Some members, noting that the Bank should maintain the current guideline, pointed out that the framework of QQE with Yield Curve Control incorporated a mechanism in which the effects of accommodative monetary policy would be further enhanced through a decline in real interest rates and a rise in the natural rate of interest, with the economy continuing to expand moderately and the inflation and potential growth rates rising. In addition, a few members noted that there were some concerns that speculation about a reduction in monetary accommodation in the United States and Europe could have effects on the Bank's policy conduct. They continued that monetary policy, however, was decided based on the economic activity and prices of each country with the aim of achieving price stability.

Meanwhile, most members concurred that it was important for Japan's economy that the Bank achieve the 2 percent price stability target. As reasons for this, some members pointed to the following: (1) the CPI's statistical tendency of demonstrating an upward bias; (2) the need to secure a safety margin for future monetary policy; and (3) the fact that a consumer price inflation rate of 2 percent was a global standard. With regard to the global standard, these members noted that major economies pursuing the same rate of inflation also would facilitate the stability of exchange rates in the long term. In relation to this discussion, one member, pointing out that the repeated postponement of the timing of achieving the price stability target could undermine the credibility of the Bank's outlook for prices, said that it would be appropriate for the Bank to change the target to a medium- to long-term and flexible one while maintaining its stance of achieving it at the earliest possible time, given that price stability was a comprehensive concept that included economic and financial stability. A different member was of the view that the Bank's policy of achieving the 2 percent target at the earliest possible time was a constraint on the flexibility of monetary policy and made it difficult to normalize monetary policy going forward; therefore, the Bank should clearly change this target to a medium- to long-term one.

With respect to yield curve control, members shared the recognition that, since the previous meeting, the JGB yield curve had been formed smoothly in a manner consistent with the guideline for market operations. One member expressed the view that, although long-term interest rates temporarily came under upward pressure through early July 2017, the Bank had been smoothly controlling the levels of interest rates by, for example, conducting fixed-rate purchase operations in a timely manner. Moreover, members confirmed that, under the current policy framework, as a result of the Bank's JGB purchases conducted so as to achieve the target level of the long-term interest rate specified by the guideline for market operations, the actual amount of such purchases varied to some extent depending on financial market conditions. One member pointed out that, should the range of the target level of 10-year JGB yields of "around 0 percent" be interpreted too strictly, it consequently could become difficult for the Bank to control long-term interest rates when a change in the price development started to occur.

Based on the above discussions, regarding the guideline for market operations for the intermeeting period, many members expressed the view that it was appropriate for the Bank to maintain the following guideline. 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, the Bank would purchase JGBs so that 10-year JGB yields would remain at around 0 percent. With regard to the amount of JGBs to be purchased, it would conduct purchases at more or less 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.

With regard to asset purchases other than 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 exchange-traded funds (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 2 percent and stayed above the target in a stable manner, 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.

On this point, a few members expressed different views. One of these members argued that the Bank should set the amounts of its asset purchases as the operating targets for monetary policy conduct and make sure to reduce them incrementally, as this would make its asset purchases more sustainable and enhance the stability of the market, thereby securing the monetary easing effects seen so far. This member expressed the recognition that, under yield curve control, it would become difficult for the Bank over time to control the amount of its JGB purchases while maintaining the target level of the long-term interest rate specified by the guideline for market operations.

A different member said that the member was in dissent with the current guideline for market operations, considering that it 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. This member, while noting 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, expressed the hope that an in-depth discussion about the appropriateness of continuing such purchases would take place going forward.

IV. Remarks by Government Representatives

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

(1) At the Group of Twenty (G-20) meeting held on July 7 and 8, 2017, it was agreed to use all policy tools -- monetary, fiscal, and structural -- individually and collectively in order to respond to downside risks and strengthen global economic growth.

(2) At the Council on Economic and Fiscal Policy held on July 18, the government decided the fiscal 2018 budget overview. It planned to decide the guidelines for budget requests for fiscal 2018 in response to the prime minister's instructions provided during the council. Regarding the budget formulation for fiscal 2018, the government would create a focused budget by eliminating wasteful budgets and ensuring priority-based budgeting that allocated funds to truly necessary measures such as investments in human resources and productivity improvements.

(3) The government expected the Bank to continue to work toward achieving the price stability target under QQE with Yield Curve Control, in light of developments in economic activity and prices, as well as financial conditions.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on a moderate recovery. The government had revised its economic assessment upward in June 2017 for the first time in six months, reflecting further improvements in both the household and corporate sectors -- as seen, for example, in the fact that the moderate pick-up in private consumption had shown its sustainability and business fixed investment had picked up. As for the outlook, the economy was expected to recover moderately, supported partly by the effects of the government's policies, while the employment and income situation continued to improve. However, attention should be given to the uncertainty in overseas economies and the effects of volatility in financial markets. In the midyear economic projections for fiscal 2017 and 2018, the real GDP growth rates were approximately 1.5 percent and 1.4 percent, respectively. In assessing price developments, it was important to comprehensively examine a wide range of price indicators, including the GDP deflator.

(2) As suggested by the Economic and Fiscal Projections for Medium- to Long-Term Analysis, the steady implementation of expenditure reform and sustainable economic growth were essential to achieving fiscal soundness. To this end, the government's task was to increase potential growth; it would focus on working-style reforms, and proceed with budget formulation so as to ensure priority-based budgeting that allocated funds to measures such as investments in human resources and productivity improvements. With regard to working-style reforms, based on the Action Plan for the Realization of Work Style Reform, the government would submit related bills to the Diet at an early date. It also would promptly try to revise the relevant act to incorporate establishment of a Sophisticated Professional System and revision to the Discretionary Working System for Management-Related Work -- both of which would contribute to productivity improvements.

(3) 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, as well as financial conditions. It deemed it important that the Bank fully explain to the public its

thinking behind the change in the projected timing of achieving the price stability target of 2 percent.

V. Votes

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

Based on the above discussions, 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 at around zero percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases at more or less 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.

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 interest 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 for 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.

B. 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.

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

Mr. T. Kiuchi proposed that the Bank use amounts of asset purchases as its operating targets and that the guidelines 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.

D. Vote on the Statement on Monetary Policy

On the basis of the above results of votes, 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).

VI. Discussion regarding the Outlook Report

Members discussed the draft of "The Bank's View" in the July 2017 Outlook Report (consisting of "The Bank's View" and "The Background") and formed a majority view.

Mr. T. Sato, however, formulated a proposal to make the following changes. First, with regard to the outlook for prices, he proposed deleting the expression that "the timing of the year-on-year rate of change in the CPI reaching around 2 percent will likely be around fiscal 2019." Second, with regard to the future conduct of monetary policy, he proposed deleting the expression that 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 2 percent and stays above the target in a stable manner." The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. T. Sato.

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

Mr. T. Kiuchi formulated a proposal to make the following changes. First, with regard to the outlook for economic activity, he proposed a new expression that the economy "is likely to continue expanding, mainly through fiscal 2018." Second, with regard to the outlook for prices, he proposed a new expression that the year-on-year rate of change in the CPI "is likely to increase very moderately for some time." Third, with regard to medium- to long-term inflation expectations, he proposed a new expression that they "are likely to remain stable at more or less the current level." Fourth, with regard to the outlook for the output gap, he proposed a new expression that it "is likely to remain more or less at a neutral level." Fifth, with regard to the future conduct of monetary policy, he proposed a new expression 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 considered most relevant to the conduct of monetary policy from a medium- to long-term perspective." 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.

To reflect the majority view, the chairman formulated a proposal on "The Bank's View" and put it to a vote.

The Policy Board decided the text of "The Bank's View" by a majority vote. It was confirmed that "The Bank's View" would be released immediately after the meeting on July 20, 2017 and the whole report would be made public on July 21.

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.

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 15 and 16, 2017 for release on July 25.

Attachment
July 20, 2017
Bank of Japan

Statement on Monetary Policy

At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided upon the following.

(1) Yield curve control

The Bank decided, by a 7-2 majority vote, to set the following guideline for market operations for the intermeeting period. [Note 1]

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 at around zero percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases at more or less 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.

(2) Guidelines for asset purchases

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

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.

[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 interest 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 for 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.

[Note 2] 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 use amounts of asset purchases as its operating targets and set the guidelines for asset purchases as follows: 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.