Not to be released until 8:50 a.m. Japan Standard Time on Friday, January 26, 2018.

January 26, 2018

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 20 and 21, 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, December 20, 2017, from 2:00 p.m. to 3:27 p.m., and on Thursday, December 21, from 9:00 a.m. to 11:39 a.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. Y. Harada

Mr. Y. Funo

Mr. M. Sakurai

Ms. T. Masai

Mr. H. Suzuki

Mr. G. Kataoka

Government Representatives Present

Mr. M. Kihara, 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 January 22 and 23, 2018 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. M. Kihara and T. Ochi were present on December 21.

[3] Messrs. T. Kabe and M. Maekawa were present on December 20.

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. 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 October 30 and 31, 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.

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 minus 0.15 to minus 0.20 percent recently.

The Nikkei 225 Stock Average remained in its highest range since the start of 2017, mainly owing to solid corporate profits, and was moving in the range of 22,500-23,000 yen recently. In the foreign exchange market, the yen had appreciated somewhat against the U.S. dollar temporarily, but had generally been more or less flat throughout the intermeeting period. Meanwhile, it had depreciated somewhat against the euro.

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 moderate increasing trend, while business fixed investment also continued to pick up. As for prices, 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.

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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.

The European economy continued to recover steadily. Exports had been increasing moderately. Private consumption had been on an increasing trend, partly supported by improvements in the labor market and consumer sentiment, while business fixed investment also had been on a moderate increasing trend. 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 1.5 percent, and that for all items excluding energy and unprocessed food had been in the range of 1.0-1.5 percent. Meanwhile, the pace of economic recovery in the United Kingdom had been slowing as the 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. As for prices, the year-on-year rate of increase in the consumer price index (CPI) had been in the range of 1.5-2.0 percent. In the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports being on an increasing trend. Economic activity in Russia and Brazil had been recovering moderately, mainly on the back of the decline in their inflation rates. In India, an upheaval in the economy due to the effects of the introduction of the Goods and Services Tax (GST) was coming to an end, and the economy was recovering moderately.

With respect to overseas financial markets, although U.S. long-term interest rates had declined temporarily, reflecting uncertainties surrounding the political situation in the United States, these rates had been generally unchanged throughout the intermeeting period, with factors such as expectations for U.S. tax reform exerting upward pressure on them. Meanwhile, stock prices in advanced economies had been at high levels, mainly reflecting solid corporate earnings and expectations for U.S. tax reform, 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 the growth in overseas economies. Those to advanced economies continued on their increasing trend when fluctuations were smoothed out; those to emerging economies had picked up for a wide range of items including electronic parts, intermediate goods, and capital goods to Asia. Exports were expected to continue their moderate increasing trend, especially for IT-related goods and capital goods.

Public investment had been more or less flat, remaining at a relatively high level. It was likely to start declining as the positive effects resulting from the second supplementary budget for fiscal 2016 diminished, and then maintain a relatively high level underpinned by Olympic Games-related construction.

Business fixed investment continued on an increasing trend with corporate profits and business sentiment improving. Looking at the *Financial Statements Statistics of Corporations by Industry, Quarterly* (FSSC), the ratio of current profits to sales for the July-September quarter of 2017 had stayed at around 6 percent, a historically high level, supported in part by solid domestic demand and the growth in overseas economies. According to the second preliminary estimate of GDP for the July-September quarter, the growth rate of real business fixed investment had marked 1.1 percent on a quarter-on-quarter basis, representing a fourth consecutive quarterly increase. The December 2017 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) showed that the year-on-year rate of change in business fixed investment plans for fiscal 2017 had clearly exceeded the past average for the December *Tankan* surveys during the period of fiscal 2004-2016. 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 monthly fluctuations. Business fixed investment was likely to continue increasing, mainly on the back of an improvement in corporate profits, accommodative financial conditions, and heightened growth expectations.

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, and the unemployment rate had declined to the range of 2.5-3.0 percent.

Private consumption had been increasing moderately, albeit with fluctuations, 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 -- had been more or less flat on the whole, although there had been a decline in durable goods recently that was due mainly to supply factors for automobiles and mobile phones. 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 rises in demand at home and abroad. It was likely to continue to increase firmly for the time being on the back of the rises in demand at home and abroad.

As for prices, the rate of increase in the producer price index (PPI) relative to three months earlier -- adjusted for the effects of seasonal changes in electricity rates -- continued to accelerate, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the CPI for all items less fresh food was in the range of 0.5-1.0 percent, while the rate of change for all items less fresh food and energy remained slightly positive. 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 continued to increase, 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 been in the range of 2.5-3.0 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds had been at a relatively high level. Firms' financial positions had been favorable.

The monetary base had been increasing at a high year-on-year growth rate in the range of 10-15 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

A. Economic Developments

Regarding global financial markets, members shared the recognition that investors had generally maintained their risk-taking stance, as stock prices in advanced economies had been at high levels, mainly against the backdrop of solid corporate profits, and capital inflows continued in many emerging economies. With regard to U.S. and European long-term interest rates, a few members expressed the view that these were generally unchanged, and in a stable manner recently, and that the policy rate hike by the Federal Reserve in the United States in December 2017 had been calmly received by market participants. A few other members pointed out that, as the background to the recent flattening of the yield curve in the United States, there was a possibility that term premiums had declined due to purchases of long-term U.S. Treasuries by the Federal Reserve and that market participants had become relatively cautious about the outlook for U.S. economic growth and inflation expectations. One member referred to the need to continue paying close attention to the possibility that interest rates would rise with inflation gaining momentum in the United States as well as other economies globally, since this could also affect capital flows of emerging economies.

With respect to overseas economies, members shared the recognition that these continued to grow at a moderate pace on the whole. They agreed that, amid trade activity having become active globally, advanced economies continued to recover steadily and emerging economies had been recovering moderately overall. One member noted that, as a pick-up in emerging economies -- which had been lagging behind that in advanced economies -- had been observed since around the second half of 2016, economies worldwide seemed to be starting to see synchronous recovery. As for the outlook, members concurred that overseas economies were likely to continue growing at a moderate pace, as advanced economies kept growing steadily and a recovery in emerging economies took hold on the back of the steady growth in advanced economies as well as 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, as seen, for example, in the fact that the real GDP growth rate on an annualized quarter-on-quarter basis for the July-September quarter of 2017 was 3.3 percent, marking the highest level in three years. One member expressed the opinion that the economy continued to grow in a well-balanced manner, including in the corporate sector, given the increasing trend in positive contributions of business fixed investment and net exports to real GDP growth. As for the outlook, members shared the view that the economy was likely to continue to see firm growth driven by domestic private demand. Some members noted that tax reform including corporate tax cuts was likely to exert upward pressure on U.S. economic growth, but that its impact and timing continued to warrant due attention.

Members shared the recognition that the European economy continued to recover steadily, with both domestic and external demand increasing moderately. One member pointed out that the European Central Bank's December 2017 staff projections for economic growth for 2018 had been revised upward from the September projections. This member then expressed the view that European economic growth was higher than had been expected. A different member added that recently released indicators had shown further improvements in business sentiment and consumer confidence. As for the outlook, members concurred that the European economy would likely continue to recover moderately, while factors such as uncertainty regarding negotiations on the United Kingdom's exit from the European Union (EU) were likely to weigh on economic activity.

Members shared the recognition that emerging economies had been recovering moderately overall. They agreed that, of these economies, the Chinese economy continued to see stable growth on the whole, although the pace had slowed somewhat compared to the relatively high growth in the July-September quarter. As background to this stable growth, a few members pointed to authorities' timely responses to economic fluctuations, and a different member referred to a high level of new car sales and a rapid spread of IT business. Members concurred that, in the NIEs and the ASEAN countries, with exports being on an increasing trend, domestic demand also had been resilient, mainly reflecting improvements in business and household sentiment and the effects of economic stimulus measures. One member expressed the recognition that commodity-exporting economies such as Russia and Brazil had been improving steadily, shifting from just an initial pick-up to a moderate recovery, mainly on the back of the decline in their inflation rates and the effects of monetary easing measures. As for the outlook, members agreed that a recovery in emerging economies was likely to take hold, due mainly to the spread of the effects of steady growth in advanced economies and the effects of economic stimulus measures taken by emerging economies. They 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 shared the recognition that factors such as U.S. economic policies, negotiations on the United Kingdom's exit from the EU, and geopolitical risks continued to be regarded as risks to developments in overseas economies. As for geopolitical risks, some members added that uncertainties were high not only over the situation in East Asia but also over that in the Middle East, the latter of which could affect commodity prices. A few members said that, in a situation where U.S. economic policies were uncertain, it was necessary to thoroughly monitor whether long-term interest rates and stock prices in the country might become highly volatile, and whether this would affect financial markets and the global economy. Meanwhile, one member expressed the view that uncertainties regarding overseas economies had waned compared to a while ago, amid, for example, a move forward in discussions on U.S. tax reform and some progress in negotiations on the United Kingdom's exit from the EU, as well as recovery in emerging and commodity-exporting economies.

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

With regard to <u>economic activity</u>, members agreed that the economy was expanding moderately, with a virtuous cycle from income to spending operating. As for developments in the corporate sector, they shared the recognition that exports had been on an increasing trend and that business fixed investment also continued on an increasing trend, with corporate profits being at a historically high level. Some members added that this recognition was consistent with the fact that the real GDP growth rate for the July-September quarter of 2017 registered relatively high growth of 2.5 percent on an annualized quarter-on-quarter basis, driven by exports and business fixed investment. Regarding the household sector, members shared the view that private consumption had been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. Based on these discussions, some members noted that Japan's economy had been growing in a well-balanced manner in both the corporate and household sectors. One member expressed the view that the ongoing economic growth was attributable not only to cyclical factors on the demand side, but also to an increase in the economy's medium- to long-term growth potential through the rises in productivity and the labor force participation rate. As for the outlook for the economy, members concurred that Japan's economy was likely to continue its moderate expansion. On a more specific note, they shared the recognition that 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 underpinnings through the government's past stimulus measures.

Members shared the recognition that exports had been on an increasing trend on the back of the growth in overseas economies. One member added that the year-on-year growth rate of the world trade volume, which had declined to around 1 percent earlier, had recovered to the range of 4.0-5.0 percent recently, and that this had been exerting positive effects on Japan's exports. As for the outlook, members concurred that exports would likely continue their moderate increasing trend for the time being, with the global economy continuing to grow at a moderate pace.

As for public investment, members shared the recognition that the real public fixed capital formation had declined for the July-September quarter, after having marked a relatively large increase for the April-June quarter due to progress with implementation of the second supplementary budget for fiscal 2016, but that such developments were in line with the initial projection. On this basis, as for the assessment of the current state of public investment, they agreed that it had been more or less flat, remaining at a relatively high level.

Members concurred that business fixed investment continued on an increasing trend with corporate profits and business sentiment improving. As reasons for revising the Bank's assessment upward from the previous one stating that business fixed investment "has been on a moderate increasing trend," some members noted that the quarter-on-quarter growth rate of real business fixed investment on a GDP basis for the July-September quarter had been revised upward to 1.1 percent, marking a continued clear increase following 1.2

percent for the April-June quarter. One member pointed out that, in the December *Tankan*, with business sentiment improving, the rate of increase in business fixed investment plans had been revised upward further from that of September. Regarding the outlook, members agreed that business fixed investment was likely to continue increasing, mainly on the back of accommodative financial conditions and heightened growth expectations. One member expressed the view that, for the time being, it was highly likely that Japan's exports would increase, supported by tailwinds of recovery in world trade, thereby leading to an increase in domestic business fixed investment. One member was of the view that, while the ratio of cash and deposit holdings to total assets at large firms had not been at an excessively high level, they had been spending their funds on overseas investment rather than on domestic business fixed investment as cross-border mergers and acquisitions in particular had been contributing to an increase in their total assets.

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. One member pointed out that labor shortages had been prevailing nationwide -- despite varying degrees among regions -- with business sentiment improving. 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, although there were views that the increasing use of robotic process automation (RPA) and artificial intelligence (AI) could ease labor market conditions, it was possible for them to tighten further because, amid expectations of a decrease in the labor force, firms could increase their need for new employees to provide new products and services brought about through innovation and to make up for a reduction in overtime work hours under working-style reforms. Meanwhile, many members noted that the recent labor shortage continued to promote firms' efforts to raise labor productivity -- for example, through labor-saving investment and streamlining of their business processes. One member then expressed the view that, in order to further drive forward firms' investment in human capital and software, it would be effective to remove regulations restricting competition and thereby encourage turnover of firms, and that real wages would increase only after labor productivity rose through these initiatives. One member pointed out that, with the prolonged shortage of demand and deflation, the labor force participation rate had declined continuously, and firms' excessive services and price cuts had resulted in constraining productivity growth. This member then said that these sorts of hysteresis effects had been waning against the background of the recent labor shortage, and expressed the opinion that, if Japan's medium- to long-term growth potential increased further with the waning of such effects, people's deflationary mindset and concern over the future would diminish gradually.

Members shared the recognition that private consumption had been increasing moderately, albeit with fluctuations. Many members agreed that, although relative weakness had been observed in some indicators, due in part to the bad weather conditions in summer 2017, there was no significant change in the improving trend in private consumption, with the employment and income situation improving steadily. In relation to this, some members said that, recently, services consumption had been increasing firmly and indicators of consumer confidence had been improving steadily. On the other hand, one member expressed the view that household spending had been restrained by an expectation that the burden to be borne by the public in the future was likely to increase in various ways, including through the consumption tax hike scheduled in 2019. In the outlook, members agreed 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. One member presented a view that, in 2018, private consumption was likely to be firm as the rates of growth in wages and salaries would probably rise further, in light of the situation of labor shortages and high levels of corporate profits. A different member commented that, in order for the economy to grow in a well-balanced manner, it was important for private consumption to become a driving force of the growth, and therefore it was worth paying attention to the extent to which consumption would improve firmly going forward amid the continued improving trend in consumer sentiment.

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 rises 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 rises in demand at home and abroad.

As for prices, members concurred that the year-on-year rate of change in the CPI for all items less fresh food was in the range of 0.5-1.0 percent, while the rate of change for all items less fresh food and energy remained slightly positive, partly as price rises by firms continued to be limited. Most members shared the recognition that prices had been relatively weak compared to the steady tightening of labor market conditions amid the moderate expansion of the economy. A few members noted that media reports on price rises had been increasing steadily, such as that prices of some standard and leading products in food and dining-out industries had been raised for the first time in more than a decade. However, these members continued that these actions taken by individual firms had not yet been vigorous enough to influence price indices. With regard to this situation, some members pointed out that many firms continued to avoid passing a rise in labor costs on to prices by making labor-saving investment and other efforts. One member added that price reductions were still being made at large retailers, for example, and that the effects of intensified competition with e-commerce business were not negligible.

In terms of the outlook for prices, most members shared the view that the year-on-year rate of change in the CPI 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. A few members pointed out that, in addition to the rises in services prices led by wage increases, prices of goods traded among firms had risen, reflecting increases in commodity prices such as crude oil prices, and that these developments might feed through into consumer prices. However, one of these members added that consumers' responsiveness to prices -- such as those of daily necessities -- remained high; thus, it still might take more time for observed inflation to rise. A different member also noted that an atmosphere in which consumers accepted a rise in prices was not yet fully realized, and thus there remained considerable uncertainties as to whether an increasing number of firms would shift their stances toward raising prices. A few members then referred to the fact that the government recently had laid out measures such as tax cuts for firms that raised wages proactively. These members expressed the view that these initiatives could lead to a breakthrough for the current situation by simultaneously pushing many firms that had been hesitant to raise wages toward changing their stances, as well as to an increase in consumers' acceptance of price rises through growth in their income.

Meanwhile, members shared the recognition that inflation expectations remained in a weakening phase. One member said that short-term inflation expectations had stopped declining on the whole. This member also noted that, regarding medium- to long-term inflation expectations, some indicators showed an uptrend but such developments were still limited. A different member pointed out that, since there remained an excess supply capacity in capital stock and the labor market, the inflation rate excluding the effects of an increase in energy prices had not risen and the dynamics through which inflation expectations rose in an adaptive manner had not been clearly in place. However, many members expressed the view that people's inflation expectations were likely to increase through the adaptive expectation formation mechanism as the observed inflation rates had been rising gradually recently and as prices were likely to increase going forward as well, mainly on the back of the improvement in the output gap.

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 Yield Curve Control, firms' funding costs had been hovering at extremely low levels and financial institutions' lending attitudes as perceived by both large and small firms continued to be proactive. One member expressed the recognition that the pace of increase in lending by regional banks remained relatively high, while that in lending by city banks to large firms had decelerated compared to a while ago, which was largely attributable to the recent absence of lending related to large-scale mergers and acquisitions.

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, these 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) indicators of medium- to long-term inflation expectations had stopped declining, with some indicators showing an uptrend, and such inflation expectations were likely to rise steadily as further price rises came to be observed widely. Following this discussion, most members shared the recognition that it was appropriate for the Bank to persistently pursue powerful monetary easing under the current guideline for market operations. Many members expressed the view that, as there was still a long way to go to achieve the price stability target of 2 percent, it was necessary to maintain the current highly accommodative financial conditions. One member pointed out that, in South Korea, which had decided on a policy rate hike recently, the inflation rate had been anchored at around 1.5 percent and the real GDP growth rate had been above 3 percent on average. This member then said that, even when compared with the situation in South Korea, it was too early for the Bank of Japan to change its monetary policy.

In relation to the conduct of monetary policy, one member pointed out that the current environment of highly accommodative financial conditions provided a good opportunity to accelerate structural reform and the growth strategy that aimed at unlocking the potential of human resources in Japan to the fullest extent possible. On this point, a different member said that, in order to raise productivity, it was necessary to have turnover of firms brought about, for example, by regulatory reform, but that this often had been hindered by increases in unemployment. This member then expressed the view that the current monetary easing policy was also contributing to facilitating productivity growth by providing economic conditions that could offer new job opportunities for the unemployed.

Members discussed the Bank's basic stance on conducting monetary policy. Some members pointed out that it was important to continue to conduct a multifaceted monitoring and assessment of the positive impacts and side effects of the current monetary easing policy -- including its effects on the functioning of financial intermediation and the financial system. One of these members expressed the view that, although the functioning of financial intermediation had not been impaired at this point, the recent situation regarding profits of banks showed that the effects of the low-interest rate environment on the financial strength of financial institutions had been accumulating. On the other hand, a different member said that, looking at the amount outstanding of lending and financial institutions' lending attitudes, the current highly accommodative financial conditions continued to strongly support corporate activity in Japan, and the risk of a gradual pullback in the functioning of financial intermediation had not been large so far. One member noted that, in the course of the inflation rate increasing toward 2 percent and the economy's medium- to long-term growth potential rising going forward, the effects of monetary easing measures would be enhanced; therefore, in conducting monetary policy, it would be necessary to take into account such changes in the environment as well as the side effects of the measures. One member -- while noting that it was appropriate to maintain the current guideline for money market operations at this point -- expressed the view that, when it was expected that economic activity and prices would continue to improve going forward, a situation might occur where the Bank would need to consider whether adjustments in the level of interest rates would be necessary under the framework of QQE with Yield Curve Control, including from the perspective of strengthening the sustainability of the framework. On the other hand, a different member expressed the view that, when mainly considering the current situation of economic activity and prices as well as risks to the outlook, the Bank should implement additional monetary easing measures under the current policy framework to strengthen the transmission effects of monetary easing on the output gap and inflation expectations, thereby raising the probability of achieving the price stability target earlier. Meanwhile, another member said that it was important for the Bank to engage in careful communication, taking into account a wide range of entities, so that its future conduct of monetary policy would not trigger unnecessary fluctuations in financial markets.

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. A few members expressed the view that real interest rates being achieved under the current yield curve control had been well below the natural rate of interest, strongly supporting the moderate expansion of Japan's economy.

Based on the above discussions, regarding the guideline for market operations for the intermeeting period, most 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.

On this point, one member expressed the opinion that, considering the risk of weaker growth in Japan's economic activity and prices due to a possible economic downturn in the United States and the consumption tax hike in Japan that was scheduled for 2019, the Bank should aim to achieve a situation in which the inflation rate would reach 2 percent in fiscal 2018 and overshoot 2 percent in fiscal 2019. This member continued that, to this end, it was appropriate for the Bank to purchase JGBs so that yields on JGBs with maturities of 10 years and longer would be broadly lowered.

With regard to asset purchases other than JGB purchases, 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. On this basis, one member -- while noting that there was no marked overheating in the market at this point -- said that policy effects and the possible side effects of the purchases of risky assets including ETFs should be examined from every angle, given that stock prices and corporate profits had substantially improved and were expected to continue to develop firmly going forward.

With respect to the Bank's thinking behind its future conduct of monetary policy, most 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.

In response to this, one member said that, with a view to reinforcing the inflation-overshooting commitment, it was appropriate for the Bank to introduce a new commitment that it would take additional easing measures if -- with regard to the median of the Policy Board members' forecasts of the CPI in the *Outlook for Economic Activity and Prices* (Outlook Report) -- there was a delay in the timing of achieving the price stability target due to domestic factors.

IV. Remarks by Government Representatives

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

(1) The budget for fiscal 2018 was planned to be decided at the Cabinet meeting to be held on December 22, 2017. Therefore, the government was in the process of finalizing the budget draft for fiscal 2018, with a view to achieving both economic revitalization and fiscal consolidation, taking into account the Plan for Economic and Fiscal Revitalization. In addition, it planned to formulate the supplementary budget for fiscal 2017 to properly deal with additional fiscal demand including that regarding disaster response. The government was working toward a Cabinet decision regarding this supplementary budget at the same time as the one regarding the budget for fiscal 2018.

(2) The ruling parties had compiled an outline on December 14 for the tax reform in fiscal 2018, which incorporated the following, in order to firmly ensure a growth trajectory for the Japanese economy: (1) revision of personal income taxation with a view to supporting workers of all working types; (2) tax measures that would encourage wage increases and business fixed investment; and (3) the enhanced business succession tax system to promote succession among small and medium-sized firms. The government would prepare draft tax codes reflecting this outline.

(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. In the government's economic outlook -- approved by the Cabinet on December 19, 2017 -- the real GDP growth rates for fiscal 2017 and 2018 were projected to be about 1.9 percent and about 1.8 percent, respectively, which were higher than those in the midyear economic projections released in July. The rate of increase in consumer prices for fiscal 2018 was projected to rise to around 1.1 percent, reflecting the tightening in demand and supply conditions

with the progress in economic recovery. In assessing price developments, it was important to comprehensively examine a wide range of price indicators, including the GDP deflator.

(2) The New Economic Policy Package was decided by the Cabinet on December 8. The government would tackle the enormous challenge of the declining birth rate and aging population by promoting "Supply System Innovation" and "Human Resources Development" as two wheels of a cart. To achieve "Supply System Innovation," it would thoroughly ensure that the record-high level of corporate profits would lead to wage increases and business fixed investment by fiscal 2020. While "Human Resources Development" was a challenge for the longer term, the government would establish a foundation by fiscal 2020 for new frameworks that were not constrained by conventional systems or practices.

(3) The government expected the Bank to work steadily toward achieving the price stability target of 2 percent, in light of developments in economic activity and prices, as well as financial conditions.

V. Votes

A. Vote 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, Ms. T. Masai, and Mr. H. Suzuki.
Votes against the proposal: Mr. G. Kataoka.

Mr. G. Kataoka dissented, considering that, taking account of risk factors such as the consumption tax hike and a possible economic downturn in the United States, it was desirable to achieve the price stability target in fiscal 2018, and that it was appropriate for the Bank to purchase JGBs so that yields on JGBs with maturities of 10 years and longer would be broadly lowered.

B. Vote on the Guideline for Asset Purchases

To reflect the 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 unanimous vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, Mr. H. Suzuki, and Mr. G. Kataoka.
Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy. Mr. G. Kataoka expressed the following opinions: (1) the possibility of the year-on-year rate of change in the CPI increasing toward 2 percent going forward was low at this point, and (2) with a view to reinforcing the inflation-overshooting commitment, if there was a delay in the timing of achieving the price stability target due to domestic factors, the Bank should take additional easing measures, and it was necessary to include that in the text.

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

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 30 and 31, 2017 for release on December 26.

Attachment

December 21, 2017

Bank of Japan

Statement on Monetary Policy

1. 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 an 8-1 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 unanimous vote, to set the following guidelines.

   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.

2. Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Overseas economies have continued to grow at a moderate pace on the whole. In

this situation, exports have been on an increasing trend. On the domestic demand side, business fixed investment has continued on an increasing trend with corporate profits and business sentiment improving. Private consumption has been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. Housing investment has been more or less flat. Meanwhile, public investment has been more or less flat, remaining at a relatively high level. Reflecting these increases in demand both at home and abroad, industrial production has been on an increasing trend, and labor market conditions have continued to tighten steadily. 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) is in the range of 0.5-1.0 percent. Inflation expectations have remained in a weakening phase.

3. With regard to the outlook, Japan's economy is likely to continue its moderate expansion. Domestic demand is 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 underpinnings through the government's past stimulus measures. Exports are expected to continue their moderate increasing trend on the back of the growth in overseas economies. The year-on-year rate of change in the CPI is 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. [Note 2]

4. Risks to the outlook include the following: the U.S. economic policies and their impact on global financial markets; developments in emerging and commodity-exporting economies; negotiations on the United Kingdom's exit from the European Union (EU) and their effects; prospects regarding the European debt problem, including the financial sector; and geopolitical risks.

5. The Bank will continue with "Quantitative and Qualitative Monetary Easing (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. It 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 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. [Note 3]

[Note 1] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki. Voting against the action: Mr. G. Kataoka. Mr. G. Kataoka dissented, considering that, taking account of risk factors such as the consumption tax hike and a possible economic downturn in the United States, it was desirable to achieve the price stability target in fiscal 2018, and that it was appropriate for the Bank to purchase JGBs so that yields on JGBs with maturities of 10 years and longer would be broadly lowered.

[Note 2] Mr. G. Kataoka opposed the description, considering that the possibility of the year-on-year rate of change in the CPI increasing toward 2 percent going forward was low at this point.

[Note 3] With a view to reinforcing the inflation-overshooting commitment, Mr. G. Kataoka opposed the description, considering that, if there was a delay in the timing of achieving the price stability target due to domestic factors, the Bank should take additional easing measures and that it was necessary to include that in the text.