Not to be released until 8:50 a.m. Japan Standard Time on Wednesday, March 14, 2018.

March 14, 2018

Bank of Japan

Minutes of the Monetary Policy Meeting

on January 22 and 23, 2018

(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 Monday, January 22, 2018, from 2:00 p.m. to 3:28 p.m., and on Tuesday, January 23, from 9:00 a.m. to 12:07 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. 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

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on March 8 and 9, 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 January 23.

[3] Messrs. T. Kabe and M. Maekawa were present on January 22.

Mr. H. Chida, Deputy Director-General, Monetary Affairs Department[4]

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. Suzuki, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

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

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

Mr. J. Ide, Senior Economist, Monetary Affairs Department

[4] Messrs. H. Chida and K. Suzuki were present on January 22 from 2:44 p.m. to 3:28 p.m.

I. Summary of Staff Reports on Economic and Financial Developments[5]

A. 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 December 20 and 21, 2017, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[6] 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 0.05 percent on the whole. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had been at around minus 0.15 percent recently.

The Nikkei 225 Stock Average had risen, due mainly to the rise in U.S. stock prices and expectations for corporate profits, and was moving in the range of 23,500-24,000 yen recently. In the foreign exchange market, amid currencies having generally appreciated against the U.S. dollar, the yen also had appreciated somewhat against it. Meanwhile, the yen basically was more or less unchanged 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 had increased. 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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[5] Reports were made based on information available at the time of the meeting.

[6] 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, U.S. and European long-term interest rates had risen, mainly against the background of economic indicators that were stronger than market expectations and an increase in inflation expectations associated largely with a rise in crude oil prices. Meanwhile, stock prices in advanced economies had been at high levels as a positive response mainly to solid corporate profits and the enactment of U.S. tax reform legislation, 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 would likely continue their increasing trend for the time being, as those of capital goods and IT-related goods were likely to be firm, and thereafter were expected to continue their moderate increasing trend, with the growth in overseas economies continuing.

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 government's large-scale stimulus measures formulated in fiscal 2016 diminished, and then remain at a relatively high level, mainly underpinned by Olympic Games-related construction.

Business fixed investment continued on an increasing trend with corporate profits and business sentiment improving. 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 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, 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 dropped for the July-September quarter of 2017, mainly due to the effects of irregular weather, but had turned upward again since October. 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 would likely continue to increase firmly for the time being on the back of the rises in demand at home and abroad. Thereafter, it was projected to continue on a moderate increasing trend with the growth in overseas economies.

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 -- had been at around 1 percent recently, 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 around 1 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 had been more or less unchanged. 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 at around 2.5 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 in the range of 3.5-4.0 percent.

II. Treatment of the Loan Support Program and Other Measures

A. Staff Reports

In order to continue to (1) encourage financial institutions' proactive efforts, as well as those of firms and households, with a view to stimulating bank lending and strengthening the foundations for economic growth, and (2) support financial institutions in disaster areas in their efforts to meet the demand for funds for rebuilding, the staff proposed that the Bank extend by one year the deadlines for new applications for such measures as the Fund-Provisioning Measure to Stimulate Bank Lending, the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth, and the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas affected by the Great East Japan Earthquake and by the 2016 Kumamoto Earthquake. The staff therefore proposed that the Bank amend the Principal Terms and Conditions for the Loan Support Program and other related rules.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the proposal. They agreed that an outline of the decision should be included in the Statement on Monetary Policy. As for the details, they concurred that the staff should accordingly make these public after the meeting.

III. Summary of Discussions by the Policy Board on Economic and Financial Developments and the January 2018 *Outlook for Economic Activity and Prices*

A. Economic Developments

Regarding global financial markets, members shared the recognition that U.S. and European long-term interest rates had been rising, mainly against the backdrop of solid economic indicators. Many members shared the view that, despite the rise in long-term interest rates, investors had generally maintained their risk-taking stance, as stock prices in advanced economies had been at high levels, particularly in light of expectations for an increase in corporate profits and the enactment of U.S. tax reform legislation, and as capital inflows to emerging economies continued. On this basis, some members pointed out that U.S. stock prices -- which had recorded a historical high -- were increasingly viewed by market participants as being overvalued judging mainly from valuation indicators. One member expressed the view that developments in long-term interest rates also warranted attention, taking into account factors such as the continued increase in the amount outstanding of credit to nonfinancial firms in the United States. Based on this discussion, some members noted that it was necessary to continue to closely monitor developments in U.S. stock prices and long-term interest rates, as they could have a significant impact on global financial markets.

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 production and trade activities in the manufacturing sector having become active globally, advanced economies continued to recover steadily and emerging economies had been recovering moderately overall. One member expressed the opinion that the recent recovery in the manufacturing sector was to some extent attributable to not only cyclical factors but also the creation of new demand associated with new technologies such as the Internet of Things (IoT) and artificial intelligence (AI). 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 had been marking an increase in the range of 3.0-3.5 percent recently. As for the outlook, they shared the recognition that the economy was likely to continue to see firm growth driven by domestic private demand. One member added that the economy was likely to continue growing at a pace above its potential, led by private consumption and business fixed investment, and that housing investment, which had been declining mainly as a result of the effects of the recent hurricanes, was likely to pick up.

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, despite facing the issues of refugees and terrorism, consumer confidence continued to improve and private consumption had been consistently resilient. As for the outlook, members concurred that the European economy would likely continue its moderate recovery, while uncertainty, including over negotiations on the United Kingdom's exit from the European Union (EU), was 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, as shown by such developments as the real GDP growth rate remaining in the range of 6.5-7.0 percent on an annual basis. One member, noting that the economic trend continued to exhibit no change after the National Congress of the Communist Party of China held in October 2017, said that, for the time being, it was worth paying attention to how the termination of tax cuts on small cars would affect automobile sales. 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. They also shared the recognition that commodity-exporting economies such as Russia and Brazil had been recovering moderately, mainly reflecting 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 recognition 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 and financial institutions' lending attitudes as perceived by both large and small firms continued to be proactive.

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 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. 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. In addition, a few members said that, based on the December 2017 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) and the reports at the January 2018 meeting of general managers of the Bank's branches, it had been reconfirmed that the benefits of the economic expansion had been spreading steadily from metropolitan to regional areas, and from large to small firms. One member expressed the recognition that an increase in demand had been supporting an expansion in the economy's supply capacity, such as through firms' efforts to raise productivity, business fixed investment with a view to expanding production capacity, and an increase in the labor force participation rate. This member then said that, with the expansion in supply capacity, the economy's medium- to long-term growth potential had been rising.

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 exports of goods such as electronic parts and intermediate goods to Asia had seen a substantial rise recently and that real exports for November 2017 had registered a record high, exceeding the level before the global financial crisis. As for the outlook, members concurred that exports would likely continue their increasing trend for the time being, with global production and trade activities in the manufacturing sector remaining at a favorable level, and thereafter were likely to continue their moderate increasing trend on the back of the growth in overseas economies.

Members shared the recognition that public investment 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. A few members expressed the view that, in addition to investment aimed at saving labor and at streamlining business processes to deal with the labor shortage, investment related to information and communications technology -- such as for AI -- as well as that aimed mainly at increasing production capacity -- such as expanding factories -- had started to increase. 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. Meanwhile, one member noted that, although business fixed investment continued to increase, the proportion of such investment to cash flows of firms had not yet become large, and that there remained a sense of excessive capital stock. Regarding this point, a different member expressed the view that, as labor market conditions tightened further, software investment for the purpose of raising productivity, among other investments, was likely to continue at small and medium-sized firms in particular, and the ratio of cash and deposit holdings to total assets at firms was likely to decline accordingly.

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. Some members pointed out that labor market conditions had tightened further, as evidenced by the active job openings-to-applicants ratio for November 2017 marking 1.56 -- its highest level since 1974 -- and by the unemployment rate declining to 2.7 percent. Moreover, some members said that they were paying attention to how developments in the annual spring labor-management wage negotiations in 2018 and their results would induce an increase in regular employees' wages and a further improvement in consumption.

Members shared the recognition that private consumption had been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. A few members expressed the view that the uptrend in private consumption had been maintained, as the CAI -- after having declined during the summer season in 2017, due mainly to weather conditions -- had been picking up since October 2017, led mainly by services and nondurable goods. 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. Meanwhile, one member pointed to the possibility of an adverse effect of the recent rise in gasoline prices on household sentiment in regional areas, where people largely depended on cars for their daily transportation. A different member expressed the recognition that, in order to increase consumption, the important thing would be how Japan's social security system would be reformed to reduce or dispel the anxiety of the working-age population regarding post-retirement life.

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, and thereafter continue on a moderate increasing trend with the growth in overseas economies.

As for prices, members concurred that the year-on-year rate of change in the CPI for all items less fresh food was around 1 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. They shared the recognition that these relatively weak developments were 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, as well as to temporary factors such as a reduction in charges for mobile phone services. Meanwhile, members agreed that it was appropriate to revise the Bank's assessment of inflation expectations upward to one stating that they "have been more or less unchanged" from the previous one stating that such expectations "have remained in a weakening phase." As reasons for this, some members pointed out that firms' and households' inflation expectations had generally stopped declining recently and market participants' inflation expectations had started to rise.

B. Outlook for Economic Activity and Prices

In formulating the January 2018 *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 underpinnings through the government's past stimulus measures. Members also agreed that exports were likely to continue their moderate increasing trend on the back of the growth in overseas economies. 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. Based on this discussion, members shared the view that

Japan's economy was likely to continue growing at a pace above its potential, mainly through fiscal 2018. They then agreed that the growth rates for the projection period of fiscal 2017-2019 were more or less unchanged compared with those presented in the October 2017 Outlook Report.

As for economic activity through fiscal 2018, members shared the view that business fixed investment was likely to continue increasing, 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 concurred that private consumption was also likely to follow a moderate increasing trend as the employment and income situation continued to improve. Members agreed that public investment would probably remain at a relatively high level, mainly reflecting Olympic Games-related demand, although the positive effects resulting from the past stimulus measures were likely to diminish moderately. Regarding fiscal 2019, they 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. Members then shared the view that the increase in exports on the back of the growth in overseas economies was likely to underpin the economy. Meanwhile, they 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, these effects 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 discussed the point that prices continued to show relatively weak developments despite the steady tightening of labor market conditions. They shared the recognition that firms' wage- and price-setting stance had been affected by 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. With regard to firms' wage-setting stance, some members expressed the view that the fact that both labor and management in Japan had a strong tendency to place priority on stability of employment over wage increases was one of the reasons why growth in wages of regular employees had been sluggish. A few members pointed out that, in the United States and Europe, there also had been an increasing awareness among labor unions in recent years to prioritize the stability of employment over the growth rate in wages, mainly in light of the substantial rise in unemployment following the global financial crisis. These members continued that, therefore, such a tendency to place priority on securing employment over wage increases was not specific to Japan. Regarding firms' price-setting stance, a few members noted that firms -- particularly those in the services sector, where room for a further increase in labor productivity remained large -- continued to avoid passing a rise in labor costs on to prices by making labor-saving investment and streamlining their business processes. Meanwhile, one member expressed the view that, given that the male employment rate was still low and that the ratio of young generation employees -- for which the unemployment rate was relatively high -- had become lower compared to the past, the unemployment rate needed to be lowered further from the current level in order to realize a sufficient rise in wages and to achieve the price stability target of 2 percent.

Many members then discussed the fact that there had been some positive changes in the environment surrounding prices. Some members pointed out that a deepening labor shortage had been exerting upward pressure on wages of not only part-time employees but also regular employees, and that an increasing number of firms had been raising the starting salaries of new graduates. Some members added that the government's call for a 3 percent increase in wages and announcement of various measures to support this also had been creating a positive atmosphere for wage increases. Some members expressed the recognition that moves to pass the rise in labor costs on to output prices had been gradually increasing recently, and that cases where such moves had led to increases in sales or profits were not few. As background to these changes, a few members pointed to the possibility that consumers' acceptance of price rises might be increasing, due mainly to an improvement in the employment and income situation, as well as a pick-up in consumer confidence that reflected a rise in stock prices. A few members expressed the view that these developments in observed prices had played a role in the indicators of inflation expectations showing a bottoming out or a rise recently. Based on this discussion, one member said that, although it had taken more time than anticipated, positive developments consistent with the projected mechanism of rising prices were being realized gradually.

Members exchanged views regarding the outlook for prices. Most members shared the view that, although the year-on-year rate of increase in the CPI had continued to show relatively weak developments, excluding the effects of a rise in energy prices, the 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 October 2017 Outlook Report, the projected rates of increase in the CPI for the projection period were more or less unchanged. 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.

Members then discussed in detail the mechanism through which the year-on-year rate of change in the CPI would increase toward 2 percent. First, most members agreed that the output gap had widened steadily within positive territory on the back of the steady tightening of labor market conditions and a rise in capital utilization rates. These 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. As background to this, these members pointed to the following: (1) in terms of the adaptive component, with the improvement in the output gap, firms' stance was likely to gradually shift toward raising wages and prices and the observed inflation rate was likely to rise steadily, 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.

In response to these discussions, one member expressed the view that excess supply capacity remained in both capital stock and the labor market, and that the situation for both of these showed that there was still a long way to go before the price stability target of 2 percent was achieved. This member then expressed the view that it was difficult to say that the output gap and inflation expectations were sufficiently working as a driving force to push up prices, and that considering developments in medium- to long-term inflation expectations, which remained at a low level, this was not a situation where one could assume with confidence that the trend inflation rate would clearly rise toward 2 percent.

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. With regard to the first factor, members shared the recognition that risks associated with the European debt problem, including in the financial sector, had decreased considerably compared to a while ago taking into account, for example, the upgrading of sovereign credit ratings for peripheral European countries and the progress in the disposal of nonperforming loans in these countries. On the other hand, many members expressed the view that it was necessary to continue paying attention to the risk that U.S. economic policies and geopolitical events would lead to adjustments in stock prices as well as fluctuations in long-term interest rates. On this basis, members concurred that, with regard to the outlook for economic activity, upside and downside risks were generally balanced.

As for 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. With regard to the first factor, they agreed that there was a risk that a rise in inflation expectations would lag behind if it took time for firms' stance to shift toward raising wages and prices and inflation consequently remained relatively sluggish. In addition, members shared the view that, with regard to goods and services that were difficult to differentiate, their prices might also constrain the acceleration of inflation if competition among firms intensified further, due mainly to changes in the distribution system and deregulation. In relation to this point, a few members added that, as a factor that could push down prices going forward, it was particularly necessary to take into account the intensified competition between existing large retail stores and online stores. On this basis, members shared the recognition that, regarding the outlook for prices, risks were skewed to the downside, especially those concerning developments in medium- to long-term inflation expectations.

IV. 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) medium- to long-term inflation expectations, which had been more or less unchanged recently, 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 noted that, given the tenacious deflationary mindset, it might take considerable time to raise inflation expectations through the adaptive formation mechanism. The member continued that it was therefore necessary for the Bank to continue to pursue powerful monetary easing with persistence, thereby supporting in a sustainable manner the positive price developments that had started to be observed. Moreover, a different member pointed out that, unlike in the United States and Europe, inflation expectations had not been firmly anchored at the level of 2 percent in Japan, and this situation had brought about firms' cautious price-setting stance. The member then commented that it therefore was important for the Bank to continue to persistently pursue the current monetary easing.

Members also 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 there did not seem to be any problem with the financial system and the functioning of financial intermediation by financial institutions at this stage, due attention needed to be paid to the changes in the market environment at home and abroad, such as the flattening of the yield curve for U.S. Treasuries and the rise in funding costs for foreign currencies, as well as to their impact on financial institutions' profits and the financial system. One member said that it also was necessary to pay attention to financial institutions' lending attitudes amid the continued low interest rate environment, given that there was a positive correlation between the banking sector's profits and lending attitude from a somewhat long-term perspective. In response, a different member pointed out that the discussion on the reversal rate -- that lowering interest rates would discourage bank lending and result in mitigating the effects of monetary easing -- focused on just one aspect of funding means solely from the supply side and did not fully take into account alternative means of raising funds by firms and the increase in their borrowing needs. One member expressed the view 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, while taking into account such changes in the environment as well as the side effects of the measures, it also might be necessary to consider what the desirable policy conduct would be. One member -- while noting that it was appropriate to maintain the current guideline for market operations at this point -- said 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 adjustment of the level of interest rates under the framework of QQE with Yield Curve Control, including from the perspective of strengthening the sustainability of the framework. A different member expressed the view that, given that it was uncertain whether the inflation rate would increase toward 2 percent by continuing the current guideline for market operations, the Bank should implement additional monetary easing measures under the current policy framework to further 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, one member -- referring to market speculation, mainly by overseas investors, that monetary easing would be slightly adjusted at an early stage -- expressed the view that, as there was still a long way to go to achieve the price stability target of 2 percent, it was not desirable to let such speculation heighten. On this point, many members pointed out that market participants had become more sensitive to the Bank's conduct of monetary policy than before as monetary policies in the United States and Europe were heading toward normalization. These members then expressed the recognition that it was therefore important for the Bank to continue to engage in careful communication.

Moreover, one member expressed the view that, in order for Japan's economy to overcome deflation and achieve sustainable growth, it was important for the government and the Bank to work together in pursuing macroeconomic policy in a powerful manner, while taking into account medium- to long-term fiscal sustainability. This member then said that, given the high ratio of the amount outstanding of government debt to GDP and a future increase in fiscal spending due to rapid population aging, continuous expansion of the fiscal deficit entailed risks. The member continued that, however, there was room to pursue fiscal policy toward overcoming deflation while maintaining medium- to long-term fiscal sustainability by adjusting the pace of fiscal consolidation.

With respect to <u>yield curve control</u>, 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. Some members pointed out that, although the reduction in the purchase amount of super-long-term JGBs for the operation on January 9, 2018 had been carried out practically based on, for example, the supply-demand conditions in the JGB market at that point, this had given rise to some market speculation about a possible reduction in the degree of monetary easing, which in turn had become one of the factors behind the appreciation of the yen. On this basis, members concurred that it was necessary for the Bank to continue communicating to the public, including overseas investors, that the amount and timing of the JGB purchases were determined practically in accordance with the guideline for market operations decided at Monetary Policy Meetings, and the conduct of market operations had no implications for the future monetary policy stance.

Based on the above discussions, regarding <u>the guideline for market operations for the intermeeting period</u>, 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, taking account of risk factors such as the scheduled consumption tax hike in Japan and a possible economic downturn in the United States, 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 broadly be lowered further. This member then added that, should the level of yields on super-long-term JGBs and a reduction in the purchase amount of JGBs have an unintended signaling effect on monetary policy, further monetary easing by the Bank would also be effective in terms of correcting this effect.

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 said that, given that stock prices and corporate profits had substantially improved and were expected to continue to develop firmly going forward, policy effects and the possible side effects of the purchases of risky assets including ETFs should be examined from every angle, while keeping in mind that such purchases were conducted as one of the components of the policy package to achieve the price stability target.

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 Report -- there was a delay in the timing of achieving the price stability target due to domestic factors.

V. Remarks by Government Representatives

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

(1) On January 22, 2018, the government submitted the budget for fiscal 2018 and the supplementary budget for fiscal 2017 to the Diet.

(2) With the budget for fiscal 2018, the government aimed to achieve both economic revitalization and fiscal consolidation -- mainly through reaching benchmarks including that of general expenditures and reducing the amount of the issue of government bonds for the sixth consecutive year since the inauguration of the Abe Cabinet -- while focusing on important issues such as (1) the expansion of childcare capacity and (2) the promotion of efforts including investment in equipment and human resources by core firms in regional areas. The supplementary budget for fiscal 2017 included expenditures amounting to 2.7 trillion yen, mainly for the purpose of funding (1) "Supply System Innovation" and "Human Resources Development," (2) projects for disaster relief, disaster prevention, and disaster reduction, and (3) measures toward realizing the goals set in the Comprehensive Trans-Pacific Partnership (TPP)-Related Policy Framework. The government would work toward obtaining approval for these budgets from the Diet at the earliest time in order to further reinforce the virtuous economic cycle and achieve sustainable economic growth.

(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 recovering at a moderate pace. Further improvement had been seen in the corporate sector, mainly in exports, industrial production, and business fixed investment. In the household sector, the employment situation was improving steadily and private consumption was picking up. The government revised its economic assessment upward on January 19, 2018 for the first time in seven months, reflecting the spread of improvement not only in the corporate sector but also in the household sector. As for the outlook, the economy was expected to continue recovering 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 assessing price developments, it was important to comprehensively examine a wide range of price indicators, including the GDP deflator.

(2) Going forward, the government would closely examine the progress in reforms at the Council on Economic and Fiscal Policy. In the basic policies for economic and fiscal management and reform to be completed this summer, it would indicate the timing of achieving a primary surplus and its plan to underpin the achievement.

(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. It also expected the Bank to continue to fully explain the situation of its monetary policy management and the outlook for prices at the Council on Economic and Fiscal Policy and on other occasions.

VI. 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 broadly be lowered further.

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.

C. Vote on the Statement on Monetary Policy

On the basis of the above results of votes, members discussed the Statement on Monetary Policy. With a view to reinforcing the inflation-overshooting commitment, Mr. G. Kataoka expressed the opinion 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 policy statement.

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. Discussion regarding the Outlook Report

Members discussed the draft of "The Bank's View" in the January 2018 Outlook Report (consisting of "The Bank's View" and "The Background") and formed a majority view.

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 January 23, 2018 and the whole report would be made public on January 24. Mr. G. Kataoka opposed the description on the outlook for the CPI, considering that the possibility of the year-on-year rate of change increasing toward 2 percent going forward was low at this point.

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.

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of December 20 and 21, 2017 for release on January 26, 2018.

Attachment

January 23, 2018

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. [Note 1]

   (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 2]

   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. The Policy Board also decided, by a unanimous vote, to extend by one year the deadlines for new applications for such measures as the Fund-Provisioning Measure to Stimulate Bank

Lending, the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth, and the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas affected by the Great East Japan Earthquake and by the Kumamoto Earthquake.

[Note 1] With a view to reinforcing the inflation-overshooting commitment, Mr. G. Kataoka dissented from the decision, 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.

[Note 2] 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 broadly be lowered further.