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September 25, 2018
Bank of Japan

Minutes of the Monetary Policy Meeting

on July 30 and 31, 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, July 30, 2018, from 2:00 p.m. to 3:30 p.m., and on Tuesday, July 31, from 9:00 a.m. to 12:56 p.m.[1]

Policy Board Members Present

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

Mr. M. Amamiya, Deputy Governor of the Bank of Japan

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

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

Mr. A. Nakamura, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. S. Kuwabara, Executive Director

Mr. E. Maeda, Executive Director

Mr. S. Uchida, Executive Director (Assistant Governor)

Mr. T. Kato, Director-General, Monetary Affairs Department

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on September 18 and 19, 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 July 31.

[3] Messrs. E. Chatani and A. Nakamura were present on July 30.

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. Y. Yamashiro, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

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

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

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

Mr. Y. Hogen, Senior Economist, Monetary Affairs Department

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

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 June 14 and 15, 2018, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, 10-year JGB yields had been at around 0 percent, and the shape of the JGB yield curve had been consistent with the guideline for market operations. Meanwhile, with regard to JGB purchases, the Bank, on July 23, 27, and 30, conducted outright purchases of long-term JGBs through the fixed-rate method (fixed-rate purchase operations).

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had generally been in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.06 to minus 0.08 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had generally been more or less unchanged and recently had been at around minus 0.15 percent.

The Nikkei 225 Stock Average had fallen through early July, mainly against the background of uncertainties over trade policy, especially between the United States and China, but rose thereafter, partly due to expectations for solid corporate profits as well as the yen's depreciation, and was moving at around 22,500 yen recently. In the foreign exchange market, in a situation where the currencies of Asian economies that had strong links with the Chinese economy had depreciated against the U.S. dollar on the whole, the yen had been depreciating somewhat against it, partly reflecting the view that there would be no change in the Federal Reserve's stance regarding a policy rate hike. Meanwhile, the yen had depreciated against the euro, mainly due to uncertainties over political developments in southern Europe waning somewhat.

[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.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow firmly on the whole.

The U.S. economy had been expanding. Exports had been on an increasing trend. Private consumption had been on an uptrend, supported in part by a favorable employment and income situation, while business fixed investment also had been increasing firmly, mainly on the back of improvement in business sentiment. As for prices, the year-on-year rate of change in the personal consumption expenditure (PCE) deflator for all items had been in the range of 2.0-2.5 percent and that for all items excluding food and energy had been at around 2.0 percent.

The European economy continued to recover, albeit at a somewhat slower pace. Growth in exports had been decelerating, mainly reflecting past appreciation of the euro. Private consumption had been on an increasing trend, partly supported by improvements in the employment and income situation and consumer sentiment, and business fixed investment also had been on such a 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, food, alcohol, and tobacco had been at about 1 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. As for prices, the year-on-year rate of change in the consumer price index (CPI) had been at around 2 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 stable inflation rates. In India, the economy had been recovering moderately, particularly in domestic demand.

With respect to overseas financial markets, investors' risk-taking stance had become cautious, as evidenced, for instance, by the depreciation of the Chinese yuan and by declines in stock prices in many countries, mainly against the background of uncertainties over trade policy, especially between the United States and China. However, since the beginning of July, some markets had been regaining stability, as shown, for example, by the fact that U.S. stock prices had started to rise, mainly on the back of solid economic indicators and of favorable corporate earnings. Meanwhile, the Turkish lira continued to depreciate, but it appeared that capital outflows from other emerging economies had come to a halt on the whole. In the commodity market, crude oil prices had been at a high level amid concern in particular over geopolitical risks in the Middle East.

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 firm growth in overseas economies. Those to advanced economies continued on their increasing trend, and those to emerging economies had picked up for a wide range of items. Exports, mainly of capital goods and IT-related goods, would likely continue their moderate increasing trend for the time being, and thereafter were expected to keep doing so with the growth in overseas economies continuing.

Public investment had been more or less flat, remaining at a relatively high level. As for the outlook, it was likely to remain at such a high level, mainly underpinned by the supplementary budget for fiscal 2017 and Olympic Games-related construction.

Business fixed investment continued on an increasing trend with corporate profits and business sentiment maintaining their improving trend. Machinery orders and construction starts in terms of planned expenses for private 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, its pace of increase was likely to decelerate gradually as pressure stemming from cyclical adjustments in capital stock heightened.

As for the employment and income situation, supply-demand conditions in the labor market continued to tighten steadily, and the pace of increase in employee income had accelerated recently. The active job openings-to-applicants ratio had been at a high level that exceeded the peak marked during the bubble period, and the unemployment rate had declined to around 2.5 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; real, travel balance adjusted) -- calculated by combining various sales and supply-side statistics -- had declined for the January-March quarter on a quarter-on-quarter basis but thereafter rose significantly for the April-May period relative to that quarter. Private consumption was expected to follow a moderate increasing trend for the time being, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as by replacement demand for durable goods. Thereafter, private consumption was expected to continue its moderate increasing trend, although it was likely to temporarily turn to a decline due to the scheduled consumption tax hike.

As for housing investment, although the number of housing starts in terms of housing for rent had been on a decreasing trend, mainly reflecting a peaking-out in demand for tax saving, owner-occupied houses had started to turn toward an increase recently, and thus housing investment had been more or less flat overall.

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

As for prices, the producer price index (PPI) relative to three months earlier -- adjusted for the effects of seasonal changes in electricity rates -- had been rising, 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, and that for all items less fresh food and energy was in the range of 0.0-0.5 percent recently. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to increase gradually toward 2 percent, mainly on the back of a rise in medium- to long-term inflation expectations with the output gap remaining positive.

2. Financial environment

Financial conditions were highly accommodative.

Inflation expectations had been more or less unchanged. Long-term real 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, such as for funds for business fixed investment, had been increasing. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been at around 2 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 year-on-year growth rate of around 7 percent. The year-on-year rate of growth in the money stock had been in the range of 3.0-3.5 percent.

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

A. Economic Developments

Regarding global financial markets, members shared the recognition that the markets had temporarily become unstable through early July, mainly against the background of uncertainties over trade policy, especially between the United States and China, but thereafter started to regain stability gradually, as shown, for example, by the fact that U.S. stock prices had started to rise, mainly on the back of solid economic indicators. Many members, however, pointed out that investors' risk sentiment could worsen again if trade friction between the United States and China intensified. One member added that, if the Chinese yuan depreciated further, due mainly to concerns over the possible negative impact on the Chinese economy, there was a risk of this having a negative impact on investors' sentiment regarding emerging markets in Asia. Many members said that it was necessary to continue to pay attention to the impact of the rise in U.S. interest rates on global capital flows and emerging economies as well. Some members -- while noting that only some countries with vulnerability in their fundamentals, such as Turkey and Argentina, were experiencing significant depreciation of their currencies so far -- commented that, given that capital inflows to many emerging economies had continued for a long period in the past, the risk always should be kept in mind that countries other than these would also inversely start to experience capital outflows.

With respect to overseas economies, members shared the recognition that they continued to grow firmly on the whole. Many members expressed the view that advanced and emerging economies had been growing in a well-balanced manner amid a continued moderate improvement in the business sentiment of manufacturing firms on a global basis. As for the outlook, members agreed that overseas economies were likely to maintain their firm growth.

With regard to developments in overseas economies by region, members concurred that the U.S. economy had been expanding. One member expressed the view that business sentiment continued to improve on the whole, as shown, for example, by the fact that the Institute for Supply Management (ISM) indices for both manufacturing and nonmanufacturing had risen for June, amid the real GDP growth rate for the April-June quarter accelerating to the range of 4-5 percent on an annualized quarter-on-quarter basis. One member said that private consumption had momentum, mainly against the background of the favorable employment and income situation, and that, despite the rise in interest rates and gasoline prices, the declining trend in automobile sales since 2016 was more moderate than initially anticipated. As for the outlook, members shared the view that the economy was likely to continue to expand.

Members shared the recognition that the European economy continued to recover, albeit at a somewhat slower pace. One member expressed the view that, although the momentum of the economy had become weaker than that in the second half of 2017, private consumption and corporate investment had been firm thereafter. A different member said that it was a positive development that trade negotiations between the United States and the European Union (EU) had progressed, but developments surrounding car tariffs still required careful attention. As for the outlook, members concurred that the European economy would likely continue its recovery. Meanwhile, one member pointed out that the Purchasing Managers' Index (PMI) for manufacturing had been relatively weak since early spring while that for services had declined for July. The member continued that due attention therefore should be paid to whether there were signs of deterioration in the European economy.

Members shared the recognition that emerging economies had been recovering moderately overall. They agreed that the Chinese economy continued to see stable growth on the whole. Members concurred that, 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. They shared the recognition that commodity-exporting economies had been recovering moderately, mainly on the back of the stable inflation rates. As for the outlook, members agreed that emerging economies were likely to continue their moderate recovery overall. They shared the view that the Chinese economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policies in a timely manner. Some members, however, raised as risks to the outlook such factors as possible intensification in trade friction between the United States and China and the effects of authorities' measures to limit financial activities. Meanwhile, one member expressed the view that depreciation of emerging economies' currencies stemming from the rise in U.S. interest rates and policy rate hikes by these economies to defend their currencies' depreciation could exert downward pressure on these economies.

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 active. Meanwhile, some members pointed out that, in the recent JGB market, the range of movement in the long-term yields had narrowed further and, notably, the trade volume of JGBs had been on a decreasing trend.

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. Some members expressed the view that, although the real GDP growth rate had paused temporarily, as evidenced, for example, by the January-March quarter having registered a negative figure for the first time in nine quarters, the rate for the April-June quarter was likely to return to positive growth. One member said that more firms recently had been making front-loaded orders for raw materials and parts and accumulating inventories, taking into consideration the increased supply-side constraints amid the continued improvement in the output gap. A different member noted that, as uncertainties for the time being, it was necessary to pay attention to the effects on economic activity of the heavy rain in July and the record-breaking heat wave continuing nationwide.

Members shared the recognition that exports had been on an increasing trend on the back of the firm growth in overseas economies. As for the outlook, they concurred that exports would likely continue their increasing trend for the time being, with global production and trade activity of the manufacturing sector remaining at a favorable level, and thereafter were likely to continue their moderate increasing trend against the background of the growth in overseas economies. One member noted the possibility of a considerable impact on Japan's exports if import tariffs on cars were raised in the United States.

Members agreed 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 maintaining their improving trend. One member commented that, while the investment stance of small nonmanufacturing firms seemed to be leveling off somewhat, other sectors maintained their active investment stance amid the favorable situation in corporate profits. Regarding the outlook, members agreed that 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. Meanwhile, one member pointed out that attention should be paid to the possibility that, if the trade friction between the United States and China intensified, this would negatively affect Japan's business fixed investment through a deterioration in sentiment of firms and investors.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to tighten steadily, and that the pace of increase in employee income had accelerated recently. A few members said that a perception of labor shortage continued to heighten, as suggested by the diffusion index for employment conditions in the June 2018 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) and by developments such as in the recent unemployment rate. One member expressed the view that, if wages of part-time employees continued to rise, this would spread to wages of regular employees, mainly those at small firms and of the younger generation. On this basis, the member pointed out that these developments already had started to be seen in such sectors as dining-out, and the rate of base pay increase resulting from this spring's annual labor-management wage negotiations had been markedly higher among small firms compared to large firms.

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. In the outlook, they concurred 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 by replacement demand for durable goods. One member -- while expecting that the growth in private consumption would accelerate gradually amid the steady increase in employee income -- pointed out that attention needed to be paid to the fact that the responsiveness of consumption to an income increase was lower in Japan than in the United States and Europe, due mainly to the high proportion of the elderly within the population.

Members shared the recognition that, while the number of housing starts in terms of housing for rent had been on a decreasing trend, mainly reflecting a peaking-out in demand for tax saving, owner-occupied houses had started to turn toward an increase, and thus 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 these rises, 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 in the range of 0.5-1.0 percent, and the rate of increase in the CPI for all items less fresh food and energy had diminished to the range of 0.0-0.5 percent, due partly to firms' cautious wage- and price-setting stance. On this basis, they shared the recognition that, taking account of the recent underlying trend in the CPI, the year-on-year rate of change in the CPI continued to show relatively weak developments compared to the economic expansion and the labor market tightening. Meanwhile, members agreed that inflation expectations had been more or less unchanged. Most members shared the recognition that, although short-term inflation expectations had risen compared to a while ago, a rise in medium- to long-term inflation expectations had been delayed mainly because of the continued relatively weak developments in observed prices.

B. Outlook for Economic Activity and Prices

In formulating the July 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, in 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, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. Members also agreed that exports were likely to continue their moderate increasing trend on the back of the firm growth in overseas economies. Based on this discussion, they shared the view that Japan's economy was likely to continue growing at a pace above its potential in fiscal 2018. Members shared the recognition that, in fiscal 2019 and 2020, Japan's economy was likely to continue on an expanding trend, partly supported by external demand, although the growth pace was projected to decelerate due to a slowdown in domestic demand. On this basis, they agreed that the projected growth rates were more or less unchanged from those presented in the April 2018 Outlook Report.

Members then discussed Japan's price developments. With regard to the continued relatively weak developments in prices, compared to the improvement in the economic and employment conditions, they shared the recognition that this essentially reflected the experience of prolonged low growth and deflation. Some members referred to the fact that the situation in which wages and prices did not increase easily, despite the robust economic conditions, had been commonly observed among major advanced economies. These members expressed the view that such situation was particularly notable in Japan, and that this was significantly attributable to the aforementioned experience unique to the country. On this basis, members concurred that, after a long and severe adjustment phase since the domestic financial crisis in the late 1990s, the mindset and behavior based on the assumption that wages and prices would not increase easily had become embedded in the economy. On this point, many members expressed the view that firms' wage-setting stance remained cautious, and that it had been taking time for wage increases, mainly for regular employees, to fully take hold. A few members said that households' cost-saving mentality had persisted and an increase in the tolerance of price rises had been lagging behind, due in part to the sluggishness in wage increases as well as cautious views regarding economic growth and the social security system going forward. Some members noted that, in this situation, firms maintained their cautious price-setting stance.

In addition to these factors, some members pointed out that Japanese firms had large room to raise productivity, mainly in the nonmanufacturing sector, and the progress in digital technology in recent years was assisting their efforts toward improving productivity. These members then commented that this situation partly enabled firms to absorb cost increases and take a cautious price-setting stance. In addition, many members said that high wage elasticity of labor supply was also slowing the pace of wage increases. Moreover, some members noted that, due in part to an expansion of online shopping in recent years, competition among retailers had further intensified, and this, coupled with consumers' preference for lower prices, had been exerting downward pressure on prices. Meanwhile, some other members pointed out that the expansion of online shopping and dull responses of administered prices and housing rent represented so-called sectoral shock. These members then expressed the view that the shock could exert downward pressure on prices in the short run; in the long run, however, it would raise people's real income and increase demand such as for other services, and therefore the effects of the shock by their nature would dissipate gradually.

Members then exchanged views regarding <u>the outlook for prices</u>. One member expressed the recognition that, as baby boomers were reaching their 70s, the effects of the rise in labor participation constraining wage increases were likely to reach their peak, and thus the rate of wage increase, mainly of non-regular employees, was likely to accelerate sooner or later. Some members noted that, as already had been observed in such sectors as dining-out, it was likely that an increasing number of firms would be unable to absorb upward pressure of costs, and thus would pass them on to sales prices. A few members pointed out that rises in non-regular employees' wage levels were likely to spread to regular employees' wages, and if this led to an increase in households' tolerance of price rises, price rises by firms were likely to be more easily accepted. Based on this discussion, most members shared the view that many of the factors that had been delaying inflation thus far -- such as firms' cautious wage- and price-setting stance and households' cost-saving mentality -- were likely to be resolved gradually in a situation where the economy continued on an expanding trend and a positive output gap was maintained. Nevertheless, some members expressed the opinion that the pace of price rises was likely to be only moderate going forward, taking into account that (1) considerable time was needed in order to change the deflationary mindset that had been embedded over years, and (2) inflation expectations, which were responsive to changes in observed prices, were unlikely to surge.

Based on the above discussion, most members shared the view that the year-on-year rate of change in the CPI was likely to increase gradually toward 2 percent as firms' stance gradually would shift toward further raising wages and prices and as medium- to long-term inflation expectations were projected to rise gradually. These members, however, agreed that it would take more time than expected to achieve 2 percent inflation, and that the projected rates of increase in the CPI for the projection period presented in the July 2018 Outlook Report were lower compared to those in the April Outlook Report.

Members then outlined, once more, the mechanism through which the year-on-year rate of change in the CPI would increase toward 2 percent, based on factors that determined general price inflation. With regard to the output gap, most members agreed that it had widened within positive territory on the back of the steady tightening of labor market conditions and a rise in capital utilization rates. Most members shared the view that, going forward, as the economy continued its moderate expansion, the output gap was likely to widen further within positive territory in fiscal 2018 and remain substantially positive in fiscal 2019 and 2020. In addition, most members shared the recognition that medium- to long-term inflation expectations were likely to follow an increasing trend and gradually converge to 2 percent. As background to this, these members pointed to the following: (1) in terms of the adaptive component, as further price rises came to be observed widely, with the output gap improving, inflation expectations were likely to increase through a rise in the observed inflation rate, 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, which would be effective in pushing up inflation expectations toward 2 percent. In response to these views, one member -- noting that the output gap was less likely to continue to widen within positive territory, and that inflation expectations continued to show relatively weak developments -- said that, therefore, under the current policy, the possibility of the inflation rate increasing gradually toward 2 percent was low.

Meanwhile, one member noted that, while the Outlook Report, for example, explained that prices were determined by macroeconomic factors, such as the output gap and medium- to long-term inflation expectations, there were still explanations of prices among the public that were based on the impact of individual prices and on sectoral shocks, such as the expansion of online shopping. On this basis, the member expressed the view that, in order to fill in the gap in understanding of price determination, it was necessary for the Bank to make efforts to provide a thorough explanation on the price determination mechanism. In relation to this, a different member said that, while the theory that the output gap and inflation expectations determined prices was appropriate when looking at the economy from a long-term perspective, attention needed to be paid to the possibility that price fluctuations from sectoral shocks would have a non-negligible impact when considering a time frame of about a few years as the scope for conducting monetary policy.

Members then discussed <u>the long-term relationship between the growth potential of Japan's economy and price developments</u>. Many members concurred that the recent increase in labor participation by women and seniors, as well as firms' efforts toward raising productivity, were likely to weaken upward pressure on wages and prices in the short term, but from a longer-term perspective, these two factors would possibly strengthen the economy's growth potential and increase upward pressure on prices. One member -- noting that productivity and employment had improved more than initially expected under powerful monetary easing -- pointed out that such improvements would eventually increase people's willingness to invest or spend and lead to a rise in inflation, even though this would take time. A different member said that the recent expansion in supply capacity was part of a process in which the negative hysteresis that had arisen in the past -- such as firms' inefficient business models -- dissipated, and that this would contribute to the sound development of Japan's economy as a whole. This member continued that, therefore, there was no need to be too pessimistic about the current sluggish increase in wages and prices.

Members also discussed <u>upside and downside risk factors</u> to the baseline scenario of the outlook for economic activity and prices. Regarding the outlook for economic activity, they noted the following four upside and downside risk factors: (1) developments in overseas economies; (2) the effects of the scheduled consumption tax hike; (3) firms' and households' medium- to long-term growth expectations; and (4) fiscal sustainability in the medium to long term. With regard to the developments in overseas economies, many members pointed out that the consequences of the recent protectionist moves and their effects warranted particular attention. In relation to this, one member expressed the view that, as such a protectionist move by a country consequently could also negatively affect its own economy, the possibility that the trade policies of the United States and other countries would completely shift to a protectionist stance was low. A different member pointed out that, if the protectionist move by the United States were to strengthen even further, this might significantly affect the business strategies of global firms and exert a non-negligible impact on global trade and investment activity. Members shared the recognition that the effects of the scheduled consumption tax hike were subject to considerable uncertainties, as it was likely that the effects of the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike, and of the decline in real income, would depend on consumer sentiment, the employment and income situation, and developments in prices. On this basis, they concurred that, with regard to the outlook for economic activity, upside and downside risks were generally balanced in fiscal 2018, but risks were skewed to the downside for fiscal 2019 onward.

As for upside and downside risks to prices, members pointed to the following three factors: (1) developments in 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. With regard to the first factor, they agreed that there was a risk that a rise in inflation expectations would lag further behind through the adaptive formation mechanism if it took longer than projected for firms' stance to shift toward further raising wages and prices and actual inflation consequently remained relatively sluggish. 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.

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 the Bank's basic stance on conducting monetary policy, most members shared the recognition that, although it would take more time than expected to achieve the 2 percent price stability target, it was appropriate to persistently continue with the current powerful monetary easing as the momentum toward achieving 2 percent inflation was being maintained. Many members expressed the recognition that, under the current powerful monetary easing, keeping the output gap within positive territory for as long as possible, thereby ensuring that the momentum toward achieving 2 percent inflation would not be lost, ultimately would lead to achieving the price stability target at the earliest possible time while securing stability in economic and financial conditions. Some members said that, in order to continue further with powerful monetary easing, it was necessary to pay close attention to the side effects stemming from this and to examine carefully whether there was room to review the policy framework with a view to minimizing such side effects as much as possible. In response, one member commented that, in the current situation where the inflation rate had been sluggish, instead of taking measures to persistently continue with monetary easing, it was necessary for the Bank to strengthen monetary easing itself so that there would be no need for such persistence.

Following the above discussion, members deliberated over issues to be examined when continuing further with powerful monetary easing. Most members shared the recognition that, in a situation where it was likely to take more time than expected to achieve the price stability target, measures that would ensure public confidence in the Bank's policy stance toward achieving the target were important. In relation to this, one member suggested considering the introduction of forward guidance adopted by overseas central banks, under which they committed to maintaining their policy rates at low levels for the future. A few members pointed out that it was appropriate for the Bank to introduce forward guidance and strengthen its commitment to achieving the price stability target at this particular timing; that is, when the projected rates of increase in the CPI turned out to be lower compared to the previous projections. Meanwhile, one member -- noting that it was questionable whether a commitment by the Bank solely to continue with the low interest rate policy would have an effect beyond merely confirming its current policy stance -- commented that it was more important to design forward guidance to stimulate aggregate demand and inflation expectations so that monetary easing would not become prolonged.

Some members then expressed the recognition that, when continuing further with monetary easing, it was necessary to establish a framework that could function in a competent manner even under prolonged easing; for example, by conducting market operations and asset purchases in a more flexible manner. One member pointed out that, while some degree of movement in long-term yields had been expected since the introduction of yield curve control, those yields determined in the markets consequently were somewhat stuck within a narrow range. On this basis, the member suggested that the Bank, while maintaining its basic framework for monetary policy -- including the target level of long-term yields of around 0 percent -- indicate that actual long-term yields might move upward and downward to some extent. Some members supported this view on the grounds that controlling the long-term yields in a more flexible manner would contribute to maintaining and improving market functioning. One member expressed the recognition that, even if interest rates were to rise somewhat from the current level, the effects of the rise on economic activity and prices were likely to be limited, while on the other hand, such a rise was likely to be effective in alleviating the cumulative impact on the functioning of financial intermediation and enhancing the sustainability of the Bank's policy. The member then noted that, referring to recent developments in long-term interest rates in major economies, it was appropriate for the Bank to allow the long-term yields to move upward and downward by around 0.25 percent. A different member said that it was appropriate to bear in mind that the long-term yields might move upward and downward at about double the range of around plus or minus 0.1 percent since the introduction of yield curve control, while using these rates as a basis. In response to these opinions, one member expressed the view that, at this point, when medium- to long-term inflation expectations were weak, making policy adjustments that could allow the long-term yields to rise might lead to an increase in real interest rates and thereby contribute to sluggish inflation. A different member commented that, among market participants who desired a rise in long-term interest rates, there were those who expected that only the rates on investment would increase without any changes in foreign exchange rates as well as prices of stocks and bonds, or a decline in firms' willingness to borrow; however, this would not happen when considering the economy as a whole.

Meanwhile, one member said that reducing the size of the Policy-Rate Balance in current accounts held by financial institutions at the Bank -- from the current level of about 10 trillion yen -- would be an option, as it had been becoming clear from developments since the introduction of the negative interest rate policy that the current size of the Policy-Rate Balance was not necessary in maintaining interest rates in the money market at around the current levels. In addition, some members suggested that, with regard to purchases of exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs), the Bank could conduct purchases with more flexibility at its current pace, thereby enhancing the sustainability of its monetary policy. One member pointed out that there also was room to revise the purchase amount of each ETF with a view to facilitating the Bank's smooth purchases.

Based on the members' views, the chairman requested that the staff explain what measures could be considered in continuing with the current powerful monetary easing from the perspective of strengthening its framework.

First, with regard to <u>forward guidance for policy rates</u>, to which some members referred, the staff explained that one option would be to indicate that the Bank intended to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019. On this point, the staff added that, looking at examples of forward guidance adopted by major central banks, at a phase when there was a long way to go to achieve their respective inflation targets, many attached to their forward guidance qualitative conditions that took into account such factors as economic developments and risk assessments. On this basis, the staff noted that, as for Japan, one option to consider would be that the Bank specify uncertainties regarding economic activity and prices as the basis for judgment on the Bank's policy stance, while referring to the important economic event that was scheduled to take place in the near future -- namely, the consumption tax hike.

Next, the staff proposed the following <u>measures to enhance the sustainability of the current monetary easing</u> while taking into consideration, for example, their effects on financial markets.

(1) Regarding short- and long-term interest rates, the Bank would maintain the current guideline for market operations. However, it would allow the long-term yields to move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, it would conduct purchases in a flexible manner so that their amount outstanding would increase at an annual pace of about 80 trillion yen.

(2) The size of the Policy-Rate Balance would be halved from the current level.

(3) As for purchases of ETFs and J-REITs, the Bank would maintain the target for the annual paces of increase in the amounts outstanding of these assets; it might increase or decrease the amount of purchases depending on market conditions. With regard to ETFs, the Bank would increase the purchase amount of those which tracked the Tokyo Stock Price Index (TOPIX).

Regarding the staff's proposal on forward guidance, many members expressed the recognition that it was appropriate from the viewpoint of strengthening the Bank's commitment to achieving the price stability target of 2 percent, and of ensuring public confidence in its policy conduct. Meanwhile, one member expressed the view that, as a monetary policy tool, forward guidance that would further clarify its relationship with the price stability target would be more desirable. In response, a different member commented that, considering the two requirements for forward guidance -- namely, ensuring the effectiveness of the Bank's commitment and the flexibility in its policy conduct -- the staff's proposal was well-balanced at present. One member said that, in an environment where the projected rates of increase in the CPI turned out to be lower compared with the previous projections, it was clear that interest rates would be maintained at low levels for a long term, and therefore there might be no significance in purposely introducing forward guidance. In response, a few members expressed the recognition that, despite relatively weak developments in prices, speculation among market participants that the Bank would shift toward the so-called exit from monetary easing had in fact tended to grow in Japan, and that the forward guidance proposed at this meeting would likely have an effect in terms of a response to such a view.

Many members then expressed the view that it was desirable to discuss the measures to enhance the sustainability of the current monetary easing in line with the staff's proposal. One member, while agreeing to the proposal that the long-term yields might move upward and downward to some extent, expressed the recognition that there should be careful consideration when mentioning the range of movement as there was a risk that the yield level would take on a life of its own. A different member noted that, since the description that the long-term yields might move to some extent was ambiguous and could be interpreted in various ways, these yields could rise more than necessary, depending on the actual conduct of market operations. The member then pointed out that, in that case, the rise could hamper the intended effects of the current yield curve control -- namely, that when economic activity improved, monetary easing effects would be enhanced by maintaining the long-term yields at 0 percent through an increase in JGB purchases. Based on these opinions, one member proposed that, if most members -- considering the yield developments since the introduction of the yield curve control -- agreed to bear in mind that the long-term yields might move upward and downward at about double the range seen to date of around plus or minus 0.1 percent, this should be made clear at the press conference to be given by the chairman after this meeting. Most members agreed to this proposal. Meanwhile, one member commented that allowing the long-term yields to move in a more flexible manner was inappropriate as market participants might misunderstand this as a measure intended to raise the interest rates. In relation to this point, some members expressed the recognition that, in order to prevent such misunderstanding, it was necessary for the Bank to make efforts toward stabilizing the yields by purchasing JGBs promptly and appropriately, in case of a rapid increase in the yields that did not reflect developments such as in economic activity and prices.

In addition, members concurred that it was appropriate to indicate that the Bank -- while maintaining the current purchase paces of ETFs and J-REITs -- might increase or decrease the amount of purchases depending on market conditions with a view to lowering risk premia of asset prices in an appropriate manner. They also agreed to the staff's proposals for changes in the amount of each ETF to be purchased and in the size of the Policy-Rate Balance. Some members expressed the view that increasing the purchase amount of ETFs that tracked the TOPIX would contribute to preventing (1) some stocks from becoming scarce in the market due to the continuation of the current purchasing method and (2) stock prices from being distorted, which had been pointed out by some market participants.

One member said that a change in the size of the Policy-Rate Balance was an adjustment to maintain the negative interest rate more efficiently, and that it was necessary to clearly explain this in order to prevent any misunderstanding that the Bank had given consideration to the profits of individual financial institutions.

One member expressed the view that, by strengthening the framework for continuous powerful monetary easing, the Bank aimed to prepare for continuing monetary easing much longer; specifically, it would enhance the sustainability and flexibility of its monetary policy by conducting the policy measures thoroughly based on the initial policy intention of QQE that implied some flexibility. One member said that it was questionable whether the measures proposed at this meeting would be taken as ones to enhance monetary easing on the whole. In response, a different member acknowledged that, in the sense of continuing further with powerful monetary easing, these measures would work in terms of enhancing the easing effects on the whole. In relation to this point, many members expressed the opinion that, since these measures were designed to strengthen the framework for continuous powerful monetary easing, the Bank should engage in careful communication so that market participants would not misinterpret that these measures were intended to reduce the degree of monetary easing or were introduced in consideration of a deterioration in the functioning of financial intermediation.

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 set the guideline as follows. First, as for the short-term policy interest rate, it would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, as for the long-term interest rate, the Bank would purchase JGBs so that 10-year JGB yields would remain at around 0 percent. While doing so, the yields might move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, it would conduct purchases in a flexible manner so that their amount outstanding would increase at an annual pace of about 80 trillion yen.

On this point, one member expressed the opinion that allowing the long-term yields to move upward and downward to some extent partly depended on the Bank's conduct of market operations, and that allowing such movements was ambiguous as the guideline for market operations decided by the Policy Board. A different member noted that it was desirable to strengthen monetary easing, taking account of, for example, the current price developments. The member continued that, even if the current target level of around 0 percent was maintained, controlling the long-term yields in a flexible manner could be misunderstood as meaning that a rise in yields was accepted by the Bank, and thus the target level might become less meaningful.

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 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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions. Second, as for CP and corporate bonds, it would maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

With respect to the Bank's thinking behind its future conduct of monetary policy, most members shared the view that it 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, (3) as for policy rates, maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019, and (4) examine the risks considered most relevant to the conduct of monetary policy and 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.

One member pointed out that, although the current monetary easing had not caused any large problems such as in the functioning of financial intermediation thus far, in continuing with such easing, it was important to (1) take into account in a compounded manner the two different time frames in which both of its positive and negative effects appeared and (2) make flexible policy adjustments depending on developments in economic activity and prices as well as financial conditions while examining the risks considered most relevant to the conduct of monetary policy. A different member, while expecting that the proposed measures would raise the inflation rate, expressed the recognition that their effects continued to warrant examination. This member also noted that, when making assessments on the financial system and market functioning, it was necessary to deepen discussion of how they should be assessed in line with the price stability target, rather than focusing on individual indicators. Meanwhile, one member said that -- with a view to reinforcing the inflation-overshooting commitment and achieving the price stability target of 2 percent at the earliest possible time -- it was necessary for the Bank to add a commitment that it would take some sort of additional monetary easing measures if the Bank revised downward its assessment of medium- to long-term inflation expectations.

IV. Remarks by Government Representatives

On the basis of the discussions on strengthening the framework for continuous powerful monetary easing, the government representatives requested that the chairman adjourn the meeting because they needed to contact the Minister of Finance and the Minister of State for Economic and Fiscal Policy. The chairman approved the request. (The meeting adjourned at 11:54 a.m. and reconvened at 12:18 p.m.)

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

(1) The government welcomed the proposals presented at this meeting as measures that would strengthen the framework for continuous powerful monetary easing in order to achieve the goal of monetary policy, and expected the Bank to make an appropriate judgment at this meeting in taking necessary measures for that purpose. The government also expected the Bank to continue to thoroughly and actively explain developments in its conduct of monetary policy, including the strengthening of the framework.

(2) The guidelines for budget requests for fiscal 2019 were approved by the Cabinet on July 10. As the new Plan for Economic and Fiscal Revitalization had been included in the Basic Policies on Economic and Fiscal Management and Reform 2018 (hereafter the Basic Policies), the government would continue to firmly undertake full-fledged expenditure reforms under the framework of this plan.

(3) With regard to the heavy rain in July 2018, the government had been exerting every effort to support those affected, including the compilation of a policy package for rebuilding the lives of those affected and restoring occupations and livelihoods that sustained their daily lives. It would continue to take all possible measures in responding to the effects of the disaster.

(4) The government expected the Bank to continue to work toward achieving the price stability target, taking account 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. As for the outlook, the economy was expected to recover through fiscal 2019, mainly led by private demand. As for risks, attention should be given to the effects of situations over trade issues on the world economy, the uncertainties regarding overseas economies, and the effects of volatility in financial markets.

(2) Regarding fluctuations in demand expected to occur around the time of the scheduled consumption tax hike, as the government needed to respond swiftly and effectively, it had decided to include temporary special measures in the initial budget for fiscal 2019.

(3) The government would aim at achieving a primary balance surplus by fiscal 2025 and stably reducing the ratio of government debt to GDP. To this end, it would work to clarify and specify directions for priority issues in expenditure reform and expenditure targets included in the Basic Policies and draft a new reform schedule by the end of 2018.

(4) The government expected the Bank to steadily pursue monetary easing toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions. It recognized that the measures to strengthen the framework for monetary easing had been proposed at this meeting in order to further clarify the Bank's intention to continue with monetary easing. The government deemed it important that the Bank thoroughly explain its thinking to the public.

(5) The government would proceed with initiatives toward reinforcing the competitiveness and growth potential of Japan's economy.

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. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

Votes for the proposal: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki.
Votes against the proposal: Mr. Y. Harada and Mr. G. Kataoka.

Mr. Y. Harada dissented, considering that allowing the long-term yields to move upward and downward to some extent was too ambiguous as the guideline for market operations decided by the Policy Board. Mr. G. Kataoka dissented, considering that (1) taking account of the current sluggishness in prices and risk factors going forward, it was desirable to strengthen monetary easing so that yields on JGBs with maturities of 10 years and longer would broadly be lowered further, and (2) controlling the long-term yields in a flexible manner would make their target level of around zero percent unclear.

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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions, 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. M. Amamiya, Mr. M. Wakatabe, 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 Entitled "Strengthening the Framework for Continuous Powerful Monetary Easing"

On the basis of the above discussions, members discussed the statement "Strengthening the Framework for Continuous Powerful Monetary Easing." Mr. Y. Harada expressed the opinion that it was appropriate to introduce forward guidance that would further clarify its relationship with the price stability target. With a view to achieving the price stability target of 2 percent at the earliest possible time, Mr. G. Kataoka expressed the opinion that it was appropriate for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations, rather than to make the commitment to maintaining the levels of short- and long-term interest rates.

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

VI. Discussion regarding the Outlook Report

Members discussed the draft of "The Bank's View" in the July 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. It also was confirmed that "Analysis on Wages and Prices," a detailed analysis on the factors behind the continued relatively weak developments in prices in Japan, would be released simultaneously with "The Bank's View," and that the full text of the Outlook Report would be made public on August 1. 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. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki.
Votes against the proposal: Mr. G. Kataoka.

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 14 and 15, 2018 for release on August 3.

VIII. Approval of the Scheduled Dates of the Monetary Policy Meetings

The Policy Board approved unanimously the dates of the Monetary Policy Meetings to be held in 2019 and agreed to make this public after the meeting.

Attachment
July 31, 2018
Bank of Japan

Strengthening the Framework for Continuous Powerful Monetary Easing

1. At the Monetary Policy Meeting (MPM) held today, with a view to persistently continuing with powerful monetary easing, the Policy Board of the Bank of Japan decided to strengthen its commitment to achieving the price stability target by introducing forward guidance for policy rates, and to enhance the sustainability of "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control."

   (1) Forward guidance for policy rates [Note 1]

   The Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019.

   (2) Yield curve control

   The Bank decided, by a 7-2 majority vote, to set the following guideline for market operations for the intermeeting period. [Note 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. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices.[6] With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

[6] In case of a rapid increase in the yields, the Bank will purchase JGBs promptly and appropriately.

(3) 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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions.[7]

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. In addition, the Bank decided to make the following adjustments in accordance with the measures described above.

a) Change in the size of the Policy-Rate Balance

The Bank, under the condition that yield curve control can be conducted appropriately, will reduce the size of the Policy-Rate Balance in financial institutions' current account balances at the Bank -- to which a negative interest rate is applied -- from the current level of about 10 trillion yen on average. This Balance is calculated assuming that arbitrage transactions take place in full among financial institutions.

b) Change in the amount of each ETF to be purchased

The Bank will revise the purchase amount of each ETF and increase that of ETFs which track the Tokyo Stock Price Index (TOPIX).

3. Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating, and labor market conditions have continued to tighten steadily. Meanwhile, prices have continued to show relatively weak developments compared to the economic and employment conditions. As shown in the July 2018 *Outlook for Economic Activity and Prices* (Outlook Report) released today, this is attributable to a combination of factors such as firms' cautious wage- and price-setting stance and households' continuous cautiousness toward price rises, and it is likely to take more time than expected to achieve the price stability target of 2

[7] The Bank will continue purchasing ETFs composed of stocks issued by firms that are proactively investing in physical and human capital at an annual pace of about 300 billion yen, as decided at the MPM held in December 2015.

percent. However, the year-on-year rate of change in the consumer price index (CPI) is likely to increase gradually toward 2 percent with the output gap remaining positive.

4. Based on the above recognition, the Bank judged it appropriate to introduce forward guidance for policy rates and to enhance the sustainability of "QQE with Yield Curve Control" by conducting market operations as well as asset purchases in a more flexible manner, thereby maintaining the output gap as long as possible within positive territory. The Bank recognizes that this will lead to achieving the price stability target of 2 percent at the earliest possible time, while securing stability in economic and financial conditions.

5. The Bank will continue with "QQE with Yield Curve Control," aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. 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 examine the risks considered most relevant to the conduct of monetary policy and 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 1] Mr. Y. Harada dissented, considering that it was appropriate to introduce forward guidance that would further clarify its relationship with the price stability target. With a view to achieving the price stability target of 2 percent at the earliest possible time, Mr. G. Kataoka dissented, considering that it was appropriate for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations, rather than to make the commitment to maintaining the levels of short- and long-term interest rates.

[Note 2] Voting for the action: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki. Voting against the action: Mr. Y. Harada and Mr. G. Kataoka. Mr. Y. Harada dissented, considering that allowing the long-term yields to move upward and downward to some extent was too ambiguous as the guideline for market operations decided by the Policy Board. Mr. G. Kataoka dissented, considering that (1) taking account of the current sluggishness in prices and risk factors going forward, it was desirable to strengthen monetary easing so that yields on JGBs with maturities of 10 years and longer would broadly be lowered further, and (2) controlling the long-term yields in a flexible manner would make their target level of around zero percent unclear.