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January 23, 2023

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 19 and 20, 2022

(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, December 19, 2022, from 2:00 p.m. to 3:50 p.m., and on Tuesday, December 20, from 9:00 a.m. to 11:54 a.m.[1]

Policy Board Members Present

Mr. KURODA Haruhiko, Chairman, Governor of the Bank of Japan
Mr. AMAMIYA Masayoshi, Deputy Governor of the Bank of Japan
Mr. WAKATABE Masazumi, Deputy Governor of the Bank of Japan
Mr. ADACHI Seiji
Mr. NAKAMURA Toyoaki
Mr. NOGUCHI Asahi
Ms. NAKAGAWA Junko
Mr. TAKATA Hajime
Mr. TAMURA Naoki

Government Representatives Present

Mr. AKINO Kozo, State Minister of Finance, Ministry of Finance[2]
Mr. OKU Tatsuo, Deputy Vice-Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. FUJIMARU Satoshi, State Minister of Cabinet Office, Cabinet Office[2]
Mr. MORO Kengo, Deputy Director General for Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. UCHIDA Shinichi, Executive Director
Ms. SHIMIZU Tokiko, Executive Director (Assistant Governor)
Mr. KAIZUKA Masaaki, Executive Director

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1 The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on January 17 and 18, 2023, 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. Akino and Fujimaru were present on December 20.

3 Messrs. Oku and Moro were present on December 19.

Mr. NAKAMURA Koji, Director-General, Monetary Affairs Department

Mr. NAKASHIMA Motoharu, Head of Policy Planning Division, Monetary Affairs Department

Mr. FUJITA Kenji, Director-General, Financial Markets Department

Mr. OTANI Akira, Director-General, Research and Statistics Department

Mr. HIROSHIMA Tetsuya, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. ITO Makoto, Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. KINOSHITA Takao, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. YOSHIMURA Haruka, Senior Economist, Monetary Affairs Department

Mr. TAKEDA Norihisa, Senior Economist, Monetary Affairs Department

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

A. Market Operations in the Intermeeting Period

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 of which were decided at the previous meeting on October 27 and 28, 2022, the Bank had been conducting purchases of Japanese government bonds (JGBs).[5] Under the guideline for fixed-rate purchase operations for consecutive days decided at that meeting, it had also conducted outright purchases of 10-year JGBs at 0.25 percent through the fixed-rate method every business day. Moreover, the Bank had carried out fixed-rate purchase operations of the cheapest-to-deliver (CTD) issues every business day. Meanwhile, it had added and changed the CTD issues applicable to fixed-rate purchase operations and to the relaxation of the terms and conditions for the Securities Lending Facility (SLF), given the rollover of JGB futures contracts. 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. However, the functioning of bond markets had deteriorated, particularly in terms of relative relationships among interest rates of bonds with different maturities and arbitrage relationships between spot and futures markets.

The Bank had conducted operations to purchase exchange-traded funds (ETFs), Japan real estate investment trusts (J-REITs), CP, and corporate bonds in accordance with the guideline for asset purchases decided at the previous meeting. In addition, it had conducted the Special Funds-Supplying Operations to Facilitate Financing in Response to the Novel Coronavirus (COVID-19) (the Special Operations to Facilitate Financing) to support financing, mainly of firms. Furthermore, with a view to meeting a wider range of financing needs, the Bank had conducted fund-provisioning under the Funds-Supplying Operations against Pooled Collateral without setting an upper limit.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments generally had been in negative territory. With regard to interest rates on overnight instruments, the

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

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

The Bank will purchase a necessary amount of JGBs without setting an upper limit so that 10-year JGB yields will remain at around zero percent.

uncollateralized call rate had been in the range of around minus 0.052 to minus 0.079 percent; general collateral (GC) repo rates had been in the range of around minus 0.084 to minus 0.119 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had decreased somewhat.

The Tokyo Stock Price Index (TOPIX) had increased, generally in line with U.S. stock prices. Long-term interest rates (10-year JGB yields) had been at around 0 percent under yield curve control. In the foreign exchange market, the yen had appreciated against the U.S. dollar, mainly due to the decline in U.S. interest rates. Meanwhile, the yen had been more or less flat against the euro throughout the intermeeting period.

C. Overseas Economic and Financial Developments

The pace of recovery in overseas economies had slowed. Supply-side constraints continued to wane globally and this had underpinned production activities around the world; however, in addition to downward pressure on advanced economies stemming from such factors as elevated inflation and policy interest rate hikes by central banks, as well as the impact of the situation surrounding Ukraine, such pressure on the Chinese economy had intensified since the previous meeting, mainly for private consumption, reflecting the impact of the COVID-19 resurgence. As for the outlook, although the effects of supply-side constraints were likely to wane, overseas economies were expected to slow, albeit with variation across countries and regions, reflecting various downward pressures. There were high uncertainties regarding the outlook, such as developments in global inflationary pressure, the course of the situation surrounding Ukraine, and the path of COVID-19 in China and its impact.

With regard to developments in overseas economies by region, the U.S. economy remained on a decelerating trend in reflection of price rises and continued policy interest rate hikes by the Federal Reserve, although private consumption had been solid. Despite downward pressure due to price rises remaining, private consumption had been solid, partly owing to the effects of discount sales, with household savings that had accumulated to date and firm labor market conditions continuing to act as underpinning factors. Housing investment had decreased in reflection of the policy interest rate hikes. Business fixed investment continued to see a small increase. Production continued to rise as a trend, albeit with weakness seen in part. Business sentiment kept improving on the whole, but the pace of improvement had paused in the manufacturing industry. Regarding prices, the year-on-year rate of change in the personal consumption expenditure (PCE) deflator maintained a high increase of about 6 percent, mainly due to the effects of tight supply and demand conditions, although it had decelerated somewhat from its peak.

European economies had recovered moderately; however, slowdowns had been observed as they continued to be affected by the situation surrounding Ukraine. Private consumption had seen a slowdown as the effects of the resumption of economic activity had peaked out and as a rise in inflation and policy interest rate hikes by the European Central Bank (ECB) continued. Exports and production had been more or less flat on the whole, albeit with fluctuations. Business fixed investment had improved as a trend. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) had been at a very high level of around 10 percent, mainly due to a rise in food and energy prices.

The Chinese economy had slowed, reflecting the impact of the COVID-19 resurgence. Private consumption had decreased due to downward pressure from the resurgence. Exports had decreased, mainly affected by inventory adjustments for some IT-related goods and for consumer goods in advanced economies, as well as by the production situation reflecting the COVID-19 resurgence. Fixed asset investment had increased moderately on the whole, although real estate investment continued to decrease. In this situation, production had slowed because the resurgence had led to a deceleration in domestic demand and affected corporate activities and the logistics situation in part.

Emerging and commodity-exporting economies other than China had picked up on the whole, albeit with weakness seen in part. The NIEs and the ASEAN economies had recovered on the whole as domestic demand continued to improve with progress in the resumption of economic activity, although exports had been somewhat weak.

With respect to overseas financial markets, while long-term interest rates in the United States had declined significantly, those in Europe had risen. Stock prices in the United States and Europe had increased, mainly reflecting the decline in U.S. interest rates and the easing of concern in Europe over energy supplies for this winter. Currencies in emerging economies had generally appreciated, as demand for the U.S. dollar had decreased, mainly reflecting the decline in U.S. interest rates. Meanwhile, crude oil prices had fallen.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy, despite being affected by factors such as high commodity prices, had picked up as the resumption of economic activity had progressed while public health had been protected from COVID-19. Regarding the outlook, the economy was likely to recover, with the impact of COVID-19 and supply-side constraints waning, although it was expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies.

Exports and production had increased as a trend, with the effects of supply-side constraints waning. Developments in real exports by goods were as follows. Exports of automobile-related goods had been on a moderate increasing trend as the tight global supply and demand conditions for semiconductors used in automobiles had eased gradually on the whole. Exports of capital goods had followed an uptrend, supported by high levels of order backlogs, although orders for semiconductor production equipment, for example, seemed to have shown signs of a slowdown. In contrast, some weakness had been observed in overall IT-related exports because, while automobile-related demand had been firm, adjustment pressure on electronic parts had intensified, mainly for semiconductors for smartphones and personal computers. Regarding the outlook, exports and production were likely to follow an uptrend, supported by the waning of supply-side constraints and high levels of order backlogs for automobiles and capital goods, although they were expected to be affected by the slowdowns in overseas economies.

Corporate profits had been at high levels on the whole. Business sentiment was more or less unchanged. Developments in the diffusion index (DI) for business conditions in the December 2022 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) by industry were as follows. The DI for manufacturing had been more or less flat, mainly because the effects of supply-side constraints had waned as a trend and firms had passed on cost increases to selling prices, while being affected by high raw material costs and a decline in IT-related demand. The DI for nonmanufacturing continued to improve, as the resumption of economic activity had progressed while public health had been protected and as firms had passed on cost increases to selling prices. However, with regard to the forecast of business conditions, the DI for manufacturing had deteriorated due to concern over the slowdowns in overseas economies, and so did that for nonmanufacturing due to concern over the impact of high prices and the COVID-19 resurgence.

Business fixed investment had increased moderately. Investment in the manufacturing industry had followed an uptrend, mainly for digital-related investment. That in the nonmanufacturing industry had also increased on the whole due to the progress in investment in logistics facilities and urban redevelopment projects. With regard to the outlook, as corporate profits remained at high levels on the whole despite being affected by such factors as high commodity prices, business fixed investment was expected to continue increasing on the back of accommodative financial conditions and the waning of supply-side constraints. Looking at leading indicators of such investment, machinery orders (private sector, excluding orders for ships and those from electric power companies) and construction starts (in terms of planned expenses for private and nonresidential construction) had both increased, albeit with fluctuations. The business fixed investment plan in the December *Tankan* showed that business fixed investment -- including software and research and development (R&D) investments but excluding land purchasing expenses, for all industries and enterprises including financial institutions -- was likely to increase by 14.7 percent on a year-on-year basis for fiscal 2022, continuing to register a large positive figure. This was based on the forecast that the effects of supply-side constraints would wane, projects that had been postponed due to COVID-19 would be carried out, and IT-related investment to digitalize business activities as well as investment to address environmental issues, such as toward decarbonization, would increase.

Private consumption had increased moderately, despite being affected by COVID-19. The consumption activity index (CAI; real, travel balance adjusted) remained more or less flat for the July-September quarter of 2022 despite the impact of the COVID-19 resurgence. It then saw an increase for October relative to that quarter, mainly for services consumption. By type, consumption of durable goods had picked up, mainly due to the waning of supply-side constraints. Consumption of nondurable goods had increased, mainly for clothes, on the back of an increase in opportunities to go out. Services consumption had increased, partly supported by the launch of the government's domestic travel discount program.

Looking at developments in private consumption since November based on anecdotal information from firms and high-frequency indicators, it seemed to have kept increasing moderately as the resumption of consumption activities had progressed while public health had been protected, and partly pushed up by the government's domestic travel discount program. Despite the price rises in food and other items since October, there had been no significant change in households' overall consumption behavior to this point. However, an increasing number of firms had pointed out that consumers were shifting to cheaper products or to stores offering special sales. Looking at confidence indicators related to private consumption, the consumer confidence index had deteriorated further, with attention being given to price rises. Regarding the outlook, private consumption was expected to be affected by price rises. However, on the back of improvement in the employment situation, it was projected to continue increasing because pent-up demand was likely to materialize, supported by household savings that had accumulated as a result of pandemic-related restrictions, as the resumption of consumption activities progressed further while public health was being protected.

The employment and income situation had improved moderately on the whole. Regarding the number of employed persons in the *Labour Force Survey*, that of regular employees had followed a moderate uptrend, mainly in the medical, healthcare, and welfare services industry, as well as the information and communications industry, both of which had faced a severe labor shortage. The number of non-regular employees had been on a moderate uptrend, mainly in the face-to-face services industry, as well as the medical, healthcare, and welfare services industry. The employment conditions DI in the December *Tankan* was at a level that was very close to the bottom hit before the pandemic, showing a continued increase in net "insufficient." The DI also revealed that labor shortage was expected to become more severe. Total cash earnings per employee had increased moderately, reflecting the pick-up in overall economic activity. With regard to the outlook, nominal employee income was likely to continue increasing along with economic recovery. In real terms, however, the year-on-year rate of change in employee income was likely to be negative for the time being, reflecting price rises.

As for prices, international commodity prices had declined. The rate of change in the producer price index (PPI) relative to three months earlier continued to be relatively high, reflecting past developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the consumer price index (CPI, all items less fresh food) had been at around 3.5 percent due to rises in prices of such items as energy, food, and durable goods. Inflation expectations had risen. Specifically, short-term expectations had increased. Medium- to long-term expectations had also risen moderately. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to increase toward the end of 2022 due to rises in prices of such items as energy, food, and durable goods. The rate of increase was then expected to decelerate toward the middle of fiscal 2023 because the contribution of such price rises to this CPI was likely to wane.

2. Financial environment

Japan's financial conditions had been accommodative on the whole, although weakness in firms' financial positions remained in some segments.

Firms' demand for funds had risen moderately as demand for working capital had increased in reflection of a pick-up in economic activity and raw material cost increases. With regard to credit supply, financial institutions' lending attitudes as perceived by firms had been accommodative. Issuance conditions for CP had been favorable. Those for corporate bonds also had been favorable on the whole, although issuance spreads had expanded. Firms' funding costs had been hovering at extremely low levels. In this situation, the year-on-year rates of increase in the amount outstanding of bank lending and the aggregate amount outstanding of CP and corporate bonds had been at around 3 percent and around 6 percent, respectively; their amounts outstanding remained at high levels. The number of bankruptcies of firms had been at a low level. Firms' financial positions continued on an improving trend, including for small and medium-sized firms, on the back of the pick-up in the economy, although weakness remained in some segments. Nevertheless, the functioning of Japan's bond markets had deteriorated, mainly due to heightened volatility in financial and capital markets at home and abroad. If this situation persisted, attention was warranted on the risk of financial conditions such as issuance conditions for corporate bonds being negatively affected.

The year-on-year rate of change in the monetary base had been negative, as the amount outstanding of funds provided through the Special Operations to Facilitate Financing had decreased. That in the money stock had been positive, in the range of 3.0-3.5 percent.

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

A. Economic and Price Developments

With regard to global financial and capital markets, members shared the view that market sentiment continued to be cautious as uncertainties over monetary tightening by central banks in the United States and Europe, as well as a slowdown in the global economy, had been drawing attention, although a slower rise in price indicators in the United States was a positive factor.

Members agreed that the pace of recovery in overseas economies had slowed. Regarding the outlook, they concurred that, although the effects of supply-side constraints were likely to wane, overseas economies were expected to slow, albeit with variation across countries and regions, reflecting the situation surrounding Ukraine and the impact of the COVID-19 resurgence in China, in addition to inflationary pressure exerted on a global basis and policy interest rate hikes by overseas central banks. Members shared the recognition that overseas economies entailed high uncertainties for the time being due to risks such as the following: global inflationary pressure; continuation of policy interest rate hikes by overseas central banks; the course of the situation surrounding Ukraine; and the situations surrounding COVID-19 and the real estate market in China. One member noted that, since there was a time lag until monetary tightening in the United States took effect, such tightening could affect not only the U.S. economy but also the global economy, depending on how much its effects had accumulated to date.

With regard to overseas economies by region, members shared the recognition that the U.S. economy remained on a decelerating trend in reflection of price rises and continued policy interest rate hikes by the Federal Reserve. A few members said that some economic data had started to indicate a slowdown in the U.S. economy due to the effects of policy interest rate hikes, and thus an increasing number of market participants were expecting a soft landing. Some members pointed out that U.S. inflation rates had decelerated. On this point, however, some members expressed the recognition that, although the rates of increase in prices of goods and energy had decelerated, those in wages and services prices remained high in the United States amid continued tight labor market conditions. These members continued that, therefore, it was highly likely to take some time to curb high inflation. In this regard, one member said that debates on whether the U.S. economy could achieve a soft landing or instead suffer a hard landing were ongoing.

Members shared the view that European economies had recovered moderately; however, slowdowns had been observed as these economies continued to be affected by the situation surrounding Ukraine. Some members expressed the view that a slowdown in economic activity in Europe was highly likely to continue as the ECB kept raising policy interest rates significantly with the inflation rates remaining high. A few members pointed out that there was a high possibility of European economies entering a recession. On the other hand, one member commented that these economies could possibly pick up since concern over energy supplies had abated.

Members agreed that the Chinese economy had slowed, reflecting the impact of the COVID-19 resurgence. One member said that private consumption in China had been relatively weak due to the strict zero-COVID policy taken until recently. A few members pointed out that, although authorities had been pushing forward with easing of zero-COVID policy and making efforts to prop up the real estate market, an increase in the number of confirmed cases and a sluggish real estate market had pushed down economic activity. Meanwhile, one member noted that there was concern over a decline in the potential growth rate due to the sluggish real estate market and the prolonged high unemployment rate among youth.

Members shared the recognition that emerging and commodity-exporting economies other than China had picked up on the whole, albeit with weakness seen in part. One member pointed out that production and exports in emerging economies had been affected by global inventory adjustments in IT-related goods, although the impact varied depending on whether those economies were commodity exporters. In addition, a different member noted that, although the effects of the appreciation of the U.S. dollar had seen a pause, attention was warranted on a possible increase in debt burden of emerging economies due to policy interest rate hikes by central banks, reflecting globally elevated inflation.

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

With regard to economic activity, members shared the view that Japan's economy, despite being affected by factors such as high commodity prices, had picked up as the resumption of economic activity had progressed while public health had been protected from

COVID-19. Some members expressed the view that, although clearer signs of slowdowns had been seen in overseas economies, Japan's economy continued to pick up, partly supported by increases in business fixed investment and private consumption, which had been constrained due to the pandemic.

As for the outlook for economic activity, members agreed that Japan's economy was likely to recover, with the impact of COVID-19 and supply-side constraints waning, although it was expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies. They shared the view that, thereafter, as a virtuous cycle from income to spending intensified gradually, the economy was projected to continue growing at a pace above its potential. One member said that this growth pace was expected due to factors such as stronger momentum for wage hikes as well as a boost in "investment in people" and investment in digital transformation; therefore, the course of wage revisions for spring 2023 and the trend in various investments warranted close monitoring. The member added that, in order for Japan's economy to see sustainable growth, it was necessary that productivity of small and medium-sized firms improve through, for example, measures to support them in enhancing their export competitiveness and strengthening their management resources through business succession, as well as measures to assist startups. This member continued that, to achieve sustainable growth, it also was essential to increase resilience against such factors as high commodity prices through the enhancement of energy self-sufficiency and to address decarbonization.

Members agreed that exports and production had increased as a trend, with the effects of supply-side constraints waning. On this point, one member pointed out that attention should be paid to whether a trend change would occur in exports, for example, as the slowdowns in overseas economies were likely to take hold.

Members shared the recognition that business fixed investment had increased moderately with corporate profits being at high levels on the whole. One member expressed the view that a virtuous cycle was maintained in the corporate sector since business fixed investment continued to increase, reflecting high levels of corporate profits. The member then stated that this was also indicated by a clear increase in the business fixed investment plan presented in the December *Tankan*. A few members were of the view that accommodative financial conditions had positively affected the increase in business fixed investment through lower real interest rates.

Members agreed that private consumption had increased moderately, despite being affected by COVID-19. A few members expressed the view that services demand had improved, particularly for eating and drinking as well as accommodations, partly owing to the effects of the government's demand stimulus measures, such as the domestic travel discount program.

Members concurred that the employment and income situation had improved moderately on the whole. They also shared the recognition that, with regard to the outlook, nominal employee income was likely to continue increasing along with economic recovery. Regarding the annual spring labor-management wage negotiations in 2023, one member expressed the recognition that there was a certain degree of possibility that relatively high wage increases would be achieved in Japan, given such factors as the following: a quite positive stance toward wage hikes among the government, labor, and management; generally favorable corporate profits; and the relationship between labor and management, where there was a strong tendency to support each other. In addition, a different member pointed out that there had been moves among labor unions to demand wage increases given the rise in prices, and that a positive stance had been observed among firms to respond to such demand amid a tightening of labor market conditions. This member continued that these developments could lead to pushing up prices in a sustainable manner. On the other hand, one member expressed the view that the recent high costs putting downward pressure on corporate profits could have negative effects on sustained wage increases. This member noted that, since the sustainability of wage hikes depended on firms' growth potential, supply-side reforms to strengthen their "earning power" were also an important factor in achieving the price stability target of 2 percent. The member added that the inflation rate for general services warranted attention as a barometer of such reforms in economic and wage structures. Moreover, one member commented that, although there seemed to be growing momentum toward wage increases from a macroeconomic perspective, the rate of increase would likely differ among firms and among employees with different attributes, such as age groups. This member continued that it was thus necessary to make efforts to examine wage developments from various aspects.

As for prices, members agreed that the year-on-year rate of change in the CPI (all items less fresh food) had been at around 3.5 percent due to rises in prices of such items as energy, food, and durable goods. With regard to the outlook, they shared the recognition that the rate of change was likely to increase toward the end of 2022 for the same reason; thereafter, the rate of increase was expected to decelerate toward the middle of fiscal 2023 because the contribution of such price rises to this CPI was likely to wane.

One member expressed the view that the year-on-year rate of increase in the CPI was expected to decelerate after the turn of 2023, considering, for example, a waning of upward pressure from import prices going forward and the government's support measures regarding electricity charges. This member added that, in fact, commodity prices, including for crude oil, had peaked out and turned to a decline and the year-on-year rate of increase in the import price index had decelerated clearly for November. A different member expressed the recognition that CPI inflation was expected to fall below 2 percent after upward pressure of costs peaked out. On this basis, the member expressed the view that, for the CPI inflation rate to accelerate again to 2 percent and stay at this level, it was necessary that nominal wages increase sufficiently and that inflation rise in items for which consumer prices were sticky, especially services. Meanwhile, one member said that an increasing number of firms had passed on cost increases to their selling prices, and that this may contribute to strengthening underlying inflation or lead to a virtuous cycle through an increase in corporate profits. A few members also expressed the view that moderate inflationary pressure could continue, given, for example, the price situation in overseas economies, the situation of the restructuring of supply chains, and developments in the pass-through of cost increases to selling prices by Japanese firms. One of these members expressed the opinion that inflation in prices of not only goods but also services had gradually risen, and that the trimmed mean and weighted median of the year-on-year rate of change in the CPI had seen a further rise; this suggested a possibility that the momentum of inflation had started to strengthen.

In addition, members shared the recognition that the underlying inflationary pressure was projected to increase on the back of improvement in the output gap and rises in medium- to long-term inflation expectations and in wage growth. One member stated that, in assessing price developments, it was necessary to examine underlying inflation by looking at various related indicators and take into account the effects of the government's comprehensive economic measures on consumer prices. On this point, a different member said that changes in the inflation rate were highly likely to be significant for the time being, mainly due to fluctuations in supply factors and the effects of government measures. This member then expressed the view that it would become even more crucial to assess underlying inflation based on the price formation mechanism. Meanwhile, one member expressed the opinion that consumer prices in Japan were approaching the state seen before the deflationary period, as suggested by the price change distribution for CPI items and by the level of the CPI excluding fresh food and energy, and that this could be considered a sign of progress toward achieving a situation where Japan's economy would not return to deflation. In response to this, a different member pointed out that, while both actual prices and inflation expectations had risen, the recent rise in services prices was largely due to the impact of high raw material costs, and that there was still a long way to go to achieve the price stability target of 2 percent in a sustainable and stable manner.

As for risks to economic activity and prices, members agreed that there were extremely high uncertainties for Japan's economy, including the following: developments in overseas economic activity and prices; developments in the situation surrounding Ukraine and in commodity prices; and the course of COVID-19 at home and abroad and its impact. One member pointed out that developments in overseas economic activity and prices had been surrounded by significant risks, including developments in the U.S. inflation rate in reflection of continued high services prices and wage growth as well as the impact of the COVID-19 resurgence in China. In addition, one member stated that it was important to continue paying close attention to the course of COVID-19 at home and abroad and its impact, such as the effects of the eighth wave of the pandemic in Japan, mainly on the eating and drinking services industry, and developments in COVID-19 in China. On this basis, members shared the view that it was necessary to pay due attention to developments in financial and foreign exchange markets and their impact on Japan's economic activity and prices.

B. Financial Developments

Members agreed that financial conditions in Japan had been accommodative on the whole, although weakness in firms' financial positions remained in some segments. A few members noted that, although firms' demand for funds had risen, mainly on the back of high raw material costs, issuance conditions for CP had been favorable and financial institutions' lending attitudes remained accommodative; thus, in general, firms had been able to secure necessary funds at low costs. On this basis, these members pointed out that spreads on corporate bond yields had widened amid deterioration in the functioning of bond markets, and that, although issuance conditions for corporate bonds seemed to have remained favorable when taking the amount and number of issuances into consideration, the current situation warranted attention.

III. Summary of Discussions on Monetary Policy

Based on the above assessment of economic and financial developments, members discussed monetary policy.

Members discussed the Bank's basic stance on its future conduct of monetary policy. They agreed that it was important to continue with the current monetary easing and thereby achieve the price stability target in a sustainable and stable manner accompanied by wage increases. A few members noted that Japan's economy was currently in a critical phase for achieving the price stability target of 2 percent in a sustainable and stable manner. One of these members said that, to achieve the target, it was necessary for medium- to long-term inflation expectations to be anchored at 2 percent and nominal wages to increase to a certain extent, and since there was still a long way to go to achieve such a situation, monetary easing should be continued. In addition, one member expressed the view that, although signs of a virtuous cycle had started to be seen, as evidenced by the overall high levels of corporate profits and moves to increase wages amid tight labor market conditions, the price stability target was not considered to have been achieved, and therefore it was appropriate for the Bank to maintain monetary easing with respect to the conduct of monetary policy for the time being. Meanwhile, one member -- noting that there had been an argument that the price stability target of 2 percent needed to be reviewed and examined, including the validity of the numerical target value -- expressed the view that revision of that value was not appropriate since it could make the target ambiguous and the monetary policy response insufficient. In response to this, a different member said that there might be room for discussion on how rigidly the Bank should adhere to the numerical value indicated by the rate of increase in the CPI. One member pointed out that it was appropriate to adopt the CPI as a measure for the central bank's price target, as was the case for other central banks. In addition, one member said that, although it was appropriate to continue with monetary easing at this point, it was necessary to examine this at some point in future and assess the balance between positive effects and side effects. A different member expressed the view that, since fund management and financing continued to be based on the assumption that interest rates would remain low for a long period, in the phase of an exit from the current monetary policy, it would be necessary to examine where the risks associated with a rise in interest rates lay and whether market participants were well prepared.

With respect to yield curve control, members shared the recognition that the JGB yield curve had been formed in a manner consistent with the guideline for market operations, as the Bank had devised various ways of conducting market operations. One member assessed that interest rates in Japan remained stable at low levels due to yield curve control even when they had been under significant upward pressure due to a surge in overseas interest rates since early spring 2022. This member added that, had domestic interest rates increased substantially due to the exogenous factor of higher overseas interest rates, this could have exerted significant downward pressure on Japan's economy. A few members expressed the view that, while observed and expected inflation rates had increased, nominal interest rates had been stable at low levels due to yield curve control, indicating that monetary easing effects had intensified through lower real interest rates.

Many members noted that there was a distortion in the price formation of 10-year bonds, and that the functioning of bond markets had deteriorated, particularly in terms of relative relationships among interest rates of bonds with different maturities and arbitrage relationships between spot and futures markets. Members shared the recognition that the functioning of Japan's bond markets had deteriorated, significantly affected by increased volatility in overseas financial and capital markets since early spring 2022. On this point, a few members noted that the November *Bond Market Survey* showed a further decline in the DI for the degree of bond market functioning. As background to this, these members pointed to factors such as reduced representativeness of 10-year JGB yields, higher volatility, and deterioration in hedging function. One of these members commented that there was a view that prospects for interest rates had not converged at the time of issuance of corporate bonds, and that this had led to a decline in investor appetite for purchasing and to wider spreads. Based on the above discussions, members concurred that, if the deterioration in the functioning of bond markets persisted, this could have a negative impact on financial conditions such as issuance conditions for corporate bonds and hamper the transmission of monetary easing effects.

Many members expressed the opinion that, from the viewpoint of addressing the deterioration in market functioning, the Bank could modify the conduct of yield curve control and thereby encourage a smoother formation of the curve. One member noted that, with a view to stabilizing the entire yield curve at a low level, it was appropriate to increase the purchase amount of JGBs for all maturities and, depending on the situation, make nimble additional purchases. The member then expressed the view that this would lead to enhancing the sustainability of monetary easing. A different member said that it was appropriate for the current accommodative policy stance to be maintained through active purchases of JGBs with various maturities. Another member expressed the opinion that it was important for the Bank to keep the level of interest rates low so as to encourage the reforms in economic and wage structures that were necessary for sustained wage increases, and that this required enhancing the sustainability of yield curve control. In relation to this, a few members expressed the recognition that, even when the range of 10-year JGB yield fluctuations from the target level was expanded, the strong easing effects exerted through lower real interest rates would continue, partly due to higher inflation expectations. Meanwhile, one member raised the issue of whether there was also room for improving the Bank's conduct of corporate bond purchases.

In response to the members' views, the chairman requested that the staff explain what responses could be considered given the deterioration in market functioning that had been pointed out by the members.

The staff provided the following explanation.

(1) Treatment of the conduct of yield curve control could be as follows.

(a) While significantly increasing the amount of JGB purchases -- namely, the amount of monthly JGB purchases to be announced in the schedule of outright purchases would be increased from 7.3 trillion yen to about 9 trillion yen -- the Bank would expand the range of 10-year JGB yield fluctuations from the target level from between around plus and minus 0.25 percentage points to between around plus and minus 0.5 percentage points.

(b) The Bank would offer to purchase 10-year JGBs at 0.5 percent every business day through fixed-rate purchase operations, unless it was highly likely that no bids would be submitted.

(c) In order to encourage the formation of a yield curve that was consistent with the guideline for market operations, the Bank would make nimble responses for each maturity by increasing the amount of JGB purchases even more and conducting fixed-rate purchase operations.

(2) Treatment of corporate bond purchases could be as follows.

(a) In adjusting the amount outstanding of corporate bonds, the Bank would give due consideration to their issuance conditions.

In response to the staff's explanation, members concurred that, with regard to the conduct of yield curve control, the measure to expand the range of 10-year JGB yield fluctuations to between around plus and minus 0.5 percentage points from the target level, while significantly increasing the amount of JGB purchases, was appropriate. One member expressed the recognition that, considering such factors as the current shape of the yield curve and past spreads among different maturities, it was reasonable that the range of 10-year JGB yield fluctuations from the target level be between around plus and minus 0.5 percentage points. One member commented that the modification of the conduct of yield curve control would contribute to improving market functioning, and on this basis expressed the view that it was important to humbly monitor where and how markets would settle and to what extent market functioning would improve. Meanwhile, some members pointed out that it was necessary for the Bank to clearly explain that the expansion of the range of 10-year JGB yield fluctuations was a policy measure to make the current monetary easing more sustainable amid heightened global inflationary pressure, and that the expansion was not a policy change toward an exit from monetary easing.

In addition, members shared the view that, with regard to the Bank's corporate bond purchases, it was appropriate to conduct purchases, giving due consideration to their issuance conditions, as proposed by the staff. One member said that it was necessary to continue to carefully examine developments in financial markets, including the effects of the above measure.

Based on the above discussions, regarding <u>the guideline for market operations for the intermeeting period</u>, members agreed that it was appropriate for the Bank to set 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 a necessary amount of JGBs without setting an upper limit so that 10-year JGB yields would remain at around 0 percent. With regard to these proposed moves, members continued that, in conducting yield curve control, it was appropriate that the Bank offer to purchase 10-year JGBs at 0.5 percent every business day for an unlimited amount through the fixed-rate method, unless it was highly likely that no bids would be submitted. They also agreed that, in order to encourage the formation of a yield curve that was consistent with the above guideline for market operations, it was appropriate that the Bank make nimble responses for each maturity by increasing the amount of JGB purchases and conducting fixed-rate purchase operations.

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. First, it would purchase ETFs and J-REITs as necessary with upper limits of about 12 trillion yen and about 180 billion yen, respectively, on annual paces of increase in their amounts outstanding. Second, the Bank would purchase CP and corporate bonds at about the same pace as prior to the COVID-19 pandemic, so that their amounts outstanding would gradually return to pre-pandemic levels, namely, about 2 trillion yen for CP and about 3 trillion yen for corporate bonds. In adjusting the amount outstanding of corporate bonds, the Bank would give due consideration to their issuance conditions.

With respect to the future conduct of monetary policy, members shared the view that the Bank would (1) continue with Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining that target in a stable manner, and (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.

Regarding its policy stance for the time being, members agreed that, while closely monitoring the impact of COVID-19, the Bank would support financing, mainly of firms, and maintain stability in financial markets, and would not hesitate to take additional easing measures if necessary. Based on this, they shared the view that, as for policy rates, the Bank would expect short- and long-term interest rates to remain at their present or lower levels.

IV. Remarks by Government Representatives

Based on the above discussions, the government representatives requested that the chairman adjourn the meeting. The chairman approved the request. (The meeting adjourned at 10:51 a.m. and reconvened at 11:28 a.m.)

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

(1) The government considered that the matters discussed today were aimed at conducting monetary easing in a more sustainable manner with a view to achieving the price stability target.

(2) The government had recently formulated comprehensive economic measures and obtained the Diet's approval of the supplementary budget to implement them. The government was currently in the process of finalizing the budget for fiscal 2023.

(3) The outline for tax reform for fiscal 2023 was formulated by the ruling parties on December 16, 2022, and the government would take appropriate actions based on it.

(4) The government expected the Bank to continue to work toward achieving the price stability target in a sustainable and stable manner while taking developments in economic activity and prices as well as financial conditions into account and cooperating with the government.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was expected to show movements of picking up, partly supported by the effects of various policies. However, a slowing down of overseas economies was a downside risk to the Japanese economy, amid ongoing global monetary tightening and other factors. Also, full attention should be given to the effects of such factors as price increases, supply-side constraints, and fluctuations in the financial and capital markets.

(2) The government would thoroughly manage progress of the comprehensive economic measures that had been formulated recently and of the supplementary budget, and implement them swiftly and steadily, so as to maximize the effects of the economic measures and thus bring about the revitalization of the Japanese economy.

(3) The government considered that the matters discussed at this meeting were aimed at conducting monetary easing in a more sustainable manner with a view to achieving the price stability target. It deemed it important for the Bank to carefully explain its policy intention to the public.

(4) The government expected the Bank to continue to conduct appropriate monetary policy, based on due consideration of developments in economic activity and prices as well as financial conditions, while closely cooperating with the government.

V. Votes

A. Vote on the Guideline for Market Operations

Based on the above discussions, to reflect the view of the members, the chairman formulated the following proposal on the guideline for market operations and put it to a vote.

The Policy Board decided the proposal by a unanimous vote.

The Chairman's Policy Proposal on the Guideline for Market Operations:

1. 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 a necessary amount of JGBs without setting an upper limit so that 10-year JGB yields will remain at around zero percent.

2. With regard to the above guideline for market operations, in conducting yield curve control, the Bank will offer to purchase 10-year JGBs at 0.5 percent every business day for an unlimited amount through the fixed-rate method, unless it is highly likely that no bids will be submitted. In order to encourage the formation of a yield curve that is consistent with the above guideline for market operations, the Bank will make nimble responses for each maturity by increasing the amount of JGB purchases and conducting fixed-rate purchase operations.

Votes for the proposal: Mr. KURODA Haruhiko, Mr. AMAMIYA Masayoshi, Mr. WAKATABE Masazumi, Mr. ADACHI Seiji, Mr. NAKAMURA Toyoaki, Mr. NOGUCHI Asahi, Ms. NAKAGAWA Junko, Mr. TAKATA Hajime, and Mr. TAMURA Naoki.

Votes against the proposal: None.

B. Vote on the Guideline for Asset Purchases

To reflect the view of the members, the chairman formulated the following proposal on the guideline for asset purchases and put it to a vote.

The Policy Board decided the proposal by a unanimous vote.

The Chairman's Policy Proposal on the Guideline for Asset Purchases:

The guideline for asset purchases other than JGB purchases will be as follows.

1. The Bank will purchase ETFs and J-REITs as necessary with upper limits of about 12 trillion yen and about 180 billion yen, respectively, on annual paces of increase in their amounts outstanding.

2. The Bank will purchase CP and corporate bonds at about the same pace as prior to the COVID-19 pandemic, so that their amounts outstanding will gradually return to pre-pandemic levels, namely, about 2 trillion yen for CP and about 3 trillion yen for corporate bonds. In adjusting the amount outstanding of corporate bonds, the Bank will give due consideration to their issuance conditions.

Votes for the proposal: Mr. KURODA Haruhiko, Mr. AMAMIYA Masayoshi, Mr. WAKATABE Masazumi, Mr. ADACHI Seiji, Mr. NAKAMURA Toyoaki, Mr. NOGUCHI Asahi, Ms. NAKAGAWA Junko, Mr. TAKATA Hajime, and Mr. TAMURA Naoki.

Votes against the proposal: None.

C. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy. The chairman formulated the Statement on Monetary Policy and put it to a vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment).

VI. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 27 and 28, 2022, for release on December 23.

Attachment
December 20, 2022
Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided to modify the conduct of yield curve control in order to improve market functioning and encourage a smoother formation of the entire yield curve, while maintaining accommodative financial conditions.

   Since early spring this year, volatility in overseas financial and capital markets has increased and this has significantly affected these markets in Japan. The functioning of bond markets has deteriorated, particularly in terms of relative relationships among interest rates of bonds with different maturities and arbitrage relationships between spot and futures markets. Yields on Japanese government bonds (JGBs) are reference rates for corporate bond yields, bank lending rates, and other funding rates. If these market conditions persist, this could have a negative impact on financial conditions such as issuance conditions for corporate bonds. The Bank expects that the measures decided today will facilitate the transmission of monetary easing effects generated under the framework of yield curve control, such as through corporate financing. The Bank will aim to achieve the price stability target by enhancing the sustainability of monetary easing under this framework through implementing these measures.

2. The Bank decided to set the guidelines for market operations and asset purchases as follows.

   (1) Yield curve control (a unanimous vote)

   a) The Bank decided to set the following guideline for market operations for the intermeeting period.

      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 a necessary amount of JGBs without setting an upper limit so that 10-year JGB yields will remain at around zero percent.

b) Conduct of yield curve control

While significantly increasing the amount of JGB purchases,[6] the Bank will expand the range of 10-year JGB yield fluctuations from the target level: from between around plus and minus 0.25 percentage points to between around plus and minus 0.5 percentage points.

The Bank will offer to purchase 10-year JGBs at 0.5 percent every business day through fixed-rate purchase operations, unless it is highly likely that no bids will be submitted. In order to encourage the formation of a yield curve that is consistent with the above guideline for market operations, the Bank will make nimble responses for each maturity by increasing the amount of JGB purchases even more and conducting fixed-rate purchase operations.

(2) Guidelines for asset purchases (a unanimous vote)

With regard to asset purchases other than JGB purchases, the Bank decided to set the following guidelines.

a) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) as necessary with upper limits of about 12 trillion yen and about 180 billion yen, respectively, on annual paces of increase in their amounts outstanding.

b) The Bank will purchase CP and corporate bonds at about the same pace as prior to the novel coronavirus (COVID-19) pandemic, so that their amounts outstanding will gradually return to pre-pandemic levels, namely, about 2 trillion yen for CP and about 3 trillion yen for corporate bonds. In adjusting the amount outstanding of corporate bonds, the Bank will give due consideration to their issuance conditions.

3. Japan's economy, despite being affected by factors such as high commodity prices, has picked up as the resumption of economic activity has progressed while public health has been protected from COVID-19. The pace of recovery in overseas economies has slowed. Exports and industrial production have increased as a trend, with the effects of supply-side constraints waning. Corporate profits have been at high levels on the whole, and business sentiment has been more or less unchanged. In this situation, business fixed investment has increased moderately. The employment and income situation has improved moderately on the whole.

6 The Bank will release "Quarterly Schedule of Outright Purchases of Japanese Government Bonds (Competitive Auction Method)" today, in which the amount of monthly JGB purchases will be increased from 7.3 trillion yen to about 9 trillion yen.

Private consumption has increased moderately, despite being affected by COVID-19. Housing investment has been relatively weak. Public investment has been more or less flat. Financial conditions have been accommodative on the whole, although weakness in firms' financial positions has remained in some segments. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) has been at around 3.5 percent due to rises in prices of such items as energy, food, and durable goods. Meanwhile, inflation expectations have risen.

4. Japan's economy is likely to recover, with the impact of COVID-19 and supply-side constraints waning, although it is expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies. Thereafter, as a virtuous cycle from income to spending intensifies gradually, Japan's economy is projected to continue growing at a pace above its potential growth rate. The year-on-year rate of change in the CPI (all items less fresh food) is likely to increase toward the end of this year due to rises in prices of such items as energy, food, and durable goods. The rate of increase is then expected to decelerate toward the middle of fiscal 2023 because the contribution of such price rises to this CPI is likely to wane. Thereafter, it is projected to accelerate again moderately on the back of improvement in the output gap and rises in medium- to long-term inflation expectations and in wage growth.

5. Concerning risks to the outlook, there remain extremely high uncertainties for Japan's economy, including the following: developments in overseas economic activity and prices; developments in the situation surrounding Ukraine and in commodity prices; and the course of COVID-19 at home and abroad and its impact. In this situation, it is necessary to pay due attention to developments in financial and foreign exchange markets and their impact on Japan's economic activity and prices.

6. The Bank will continue with Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner.

   For the time being, while closely monitoring the impact of COVID-19, the Bank will support financing, mainly of firms, and maintain stability in financial markets, and will not hesitate to take additional easing measures if necessary; it also expects short- and long-term policy interest rates to remain at their present or lower levels.