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December 26, 2017

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 30 and 31, 2017

(English translation prepared by the Bank's staff based on the Japanese original)

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Monday, October 30, 2017, from 2:00 p.m. to 3:09 p.m., and on Tuesday, October 31, from 9:00 a.m. to 11:58 a.m.[1]

Policy Board Members Present

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

Mr. K. Iwata, Deputy Governor of the Bank of Japan

Mr. H. Nakaso, Deputy Governor of the Bank of Japan

Mr. Y. Harada

Mr. Y. Funo

Mr. M. Sakurai

Ms. T. Masai

Mr. H. Suzuki

Mr. G. Kataoka

Government Representatives Present

Mr. M. Kihara, State Minister of Finance, Ministry of Finance[2]

Mr. T. Kabe, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

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

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

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. S. Kuwabara, Executive Director

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

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

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on December 20 and 21, 2017 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. M. Kihara and T. Ochi were present on October 31.

[3] Messrs. T. Kabe and M. Maekawa were present on October 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. H. Nakamoto, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

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

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

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

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the short-term policy interest rate of minus 0.1 percent and the target level of the long-term interest rate, both decided at the previous meeting on September 20 and 21, 2017, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, 10-year JGB yields had been at around 0 percent, and the shape of the JGB yield curve had been consistent with the guideline for market operations.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had generally been in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.02 to minus 0.06 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had been at around minus 0.2 percent recently.

The Nikkei 225 Stock Average had risen significantly, due in part to expectations of an improvement in corporate profits, in a situation where the yen had been depreciating somewhat against the U.S. dollar. It had been at around 22,000 yen recently, the highest level in 21 years. In the foreign exchange market, the yen had depreciated somewhat against the U.S. dollar, mainly reflecting the widening interest rate differential between Japan and the United States. Meanwhile, it basically was more or less unchanged against the euro.

C. Overseas Economic and Financial Developments

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

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

[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.

expenditure (PCE) deflator for all items and that for all items excluding food and energy had been at around 1.5 percent.

The European economy continued to recover steadily. Exports had been increasing moderately. Private consumption had been on an increasing trend, partly supported by improvements in the labor market and consumer sentiment, while business fixed investment also had been on a moderate increasing trend. With regard to prices, both the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items and that for all items excluding energy and unprocessed food had been at around 1.5 percent. Meanwhile, the pace of economic recovery in the United Kingdom had been slowing as the rise in prices had been weighing on private consumption.

With regard to emerging economies, the Chinese economy continued to see stable growth on the whole, partly due to the effects of authorities' measures to support economic activity. As for prices, the year-on-year rate of increase in the consumer price index (CPI) had been at around 1.5 percent. Meanwhile, in the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports increasing. Economic activity in Russia and Brazil had picked up, mainly on the back of the bottoming out of commodity prices earlier. In India, the economy had been heading toward recovery, albeit with some fluctuations due to the effects of the introduction of the Goods and Services Tax (GST).

With respect to overseas financial markets, U.S. long-term interest rates had risen, mainly against the backdrop of waning concern over geopolitical risks and solid economic indicators, while European long-term interest rates generally were unchanged, partly due to uncertainties surrounding political situations in Europe. Meanwhile, stock prices had risen in many countries, mainly due to expectations of an improvement in corporate profits as well as waning concern over geopolitical risks, and capital inflows to emerging economies continued.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy was expanding moderately, with a virtuous cycle from income to spending operating. Exports had been on an increasing trend on the back of the growth in overseas economies. Those to advanced economies continued on their increasing trend;

those to emerging economies had picked up, led mainly by electronic parts and intermediate goods to Asia. Exports would likely continue their increasing trend for the time being, as those of IT-related goods and capital goods were likely to be firm, and thereafter were expected to continue their moderate increasing trend, with the growth in overseas economies continuing.

Public investment had been increasing. It was likely to remain more or less flat at a high level for the time being, due in part to investment in measures for restoration and rebuilding following the Kumamoto Earthquake and a variety of infrastructure enhancements. Thereafter, it was expected to start declining as the positive effects resulting from the set of stimulus measures diminished, and then maintain a relatively high level underpinned by Olympic Games-related construction.

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

As for the employment and income situation, supply-demand conditions in the labor market continued to tighten steadily and employee income had increased moderately. The active job openings-to-applicants ratio had followed a steady improving trend, and the unemployment rate had declined to the range of 2.5-3.0 percent.

Private consumption had increased its resilience against the background of steady improvement in the employment and income situation. The consumption activity index (CAI) -- calculated by combining various sales and supply-side statistics -- had increased, albeit with fluctuations mainly stemming from weather conditions. Private consumption was expected to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as replacement demand for durable goods.

Housing investment had been more or less flat.

Industrial production had been on an increasing trend against the background of increases in demand at home and abroad. It was likely to continue to increase firmly for the time being on the back of the increases in demand at home and abroad. Thereafter, it was projected to continue on a moderate increasing trend with the growth in overseas economies.

As for prices, the rate of change in the producer price index (PPI) -- adjusted for the effects of seasonal changes in electricity rates -- had been slightly positive compared with three months earlier, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the CPI for all items less fresh food was in the range of 0.5-1.0 percent, while the rate of change for all items less fresh food and energy remained slightly positive. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to continue on an uptrend and increase toward 2 percent, mainly on the back of an improvement in the output gap and a rise in medium- to long-term inflation expectations.

2. Financial environment

Financial conditions were highly accommodative.

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

Firms' funding costs had been hovering at extremely low levels. With regard to credit supply, financial institutions' lending attitudes -- as perceived by firms -- had been highly accommodative. Issuing conditions for CP and corporate bonds had been favorable. Firms' credit demand continued to increase, such as for funds related to mergers and acquisitions, as well as for those for business fixed investment. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been at around 3 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds had been at a relatively high level. Firms' financial positions had been favorable.

The monetary base had been increasing at a high year-on-year growth rate of around 15 percent. The year-on-year rate of growth in the money stock had been at around 4 percent.

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

A. Economic Developments

Regarding global financial markets, members shared the recognition that U.S. and European long-term interest rates had been stable as concern over geopolitical risks had waned compared to a while ago, and that stock prices in major economies -- the United States and Germany in particular -- had been rising, mainly due to expectations of an improvement in corporate profits and solid economic indicators. While some members saw the recent strong performance of stock prices as providing solid evidence of an economic improvement, they pointed to the need to continue paying close attention to developments in the stock market from various perspectives, including geopolitical risks, as they acknowledged some market participants' concern about overheating. A few members expressed the view that central banks in the United States and Europe had been proceeding with monetary policy normalization with great care, and that this had been contributing to the recent stability in global financial markets.

With respect to overseas economies, members agreed that, as the global recovery in trade activity continued, advanced economies continued to recover steadily and emerging economies had picked up on the whole. On this basis, they shared the recognition that overseas economies continued to grow at a moderate pace on the whole. As for the outlook, members concurred that overseas economies were likely to continue growing at a moderate pace, as advanced economies kept growing steadily and a recovery in emerging economies took hold on the back of the steady growth in advanced economies as well as the effects of policy measures taken by emerging economies. One member said that it was likely that business fixed investment in overseas economies, which had been restrained for the past few years, would gather pace as uncertainty regarding economic developments abated, and therefore the probability that overseas economies would continue to grow through 2018 was rising.

With regard to developments in overseas economies by region, members concurred that the U.S. economy continued to recover firmly, mainly in household spending, as seen, for example, in the fact that the real GDP growth rate on an annualized quarter-on-quarter basis for the April-June quarter of 2017 was 3.1 percent and that for the July-September quarter was 3.0 percent. A few members expressed the view that downward pressure on private consumption from the major hurricanes was dissipating, as suggested by the fact that motor vehicle sales and retail sales for September had rebounded relatively strongly. As for the outlook, members shared the recognition that the economy was likely to continue to see firm growth driven by domestic private demand.

Members shared the recognition that the European economy continued to recover steadily, with both domestic and external demand increasing moderately. One member pointed out that developments in the Purchasing Managers' Index (PMI) for manufacturing activity for the euro area and the ifo Business Climate Index for Germany suggested a considerable improvement in business sentiment in Europe. As for the outlook, members concurred that the European economy would likely follow a moderate recovery trend, while factors such as uncertainty regarding negotiations on the United Kingdom's exit from the European Union were likely to weigh on economic activity. One member said that the European Central Bank's decision to reduce the pace of its net asset purchases had had a limited impact on the market so far, and that this was largely attributable to market participants' favorable outlook on the economy.

Members shared the recognition that emerging economies had picked up on the whole. They agreed that, of these economies, the Chinese economy continued to see stable growth on the whole, partly due to the effects of authorities' measures to support economic activity, as evidenced, for example, by the fact that the real GDP growth rate remained firm, marking 6.8 percent on a year-on-year basis for the July-September quarter. One member pointed out that China's initiatives to reduce excess inventories and production capacity over the past few years consequently had exerted a positive impact on Asian economies, including Japan's, through both exports and imports. Members concurred that in the NIEs and the ASEAN countries, with exports increasing, domestic demand also had been resilient, mainly reflecting improvements in business and household sentiment and the effects of economic stimulus measures. They also shared the recognition that economic activity in commodity-exporting countries such as Russia and Brazil had picked up, mainly reflecting the bottoming out of commodity prices earlier and the effects of monetary easing measures. As for the outlook, members agreed that a recovery in emerging economies was likely to take hold, due mainly to the spread of the effects of steady growth in advanced economies and the effects of policy measures taken by emerging economies. They shared the recognition that the Chinese economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policy in a timely manner. One member, while pointing to an overheating of the real estate market and subsequent adjustments as risks associated with the Chinese economy, expressed the view that the market had been relatively calm so far and currently was expected to make a soft landing.

Members concurred that financial conditions in Japan were highly accommodative. They shared the view that, under Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, firms' funding costs had been hovering at extremely low levels and financial institutions' lending attitudes as perceived by both large and small firms continued to be proactive.

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

With regard to economic activity, members agreed that the economy was expanding moderately, with a virtuous cycle from income to spending operating. As for developments in the corporate sector, they shared the recognition that exports had been on an increasing trend and business fixed investment had been on a moderate increasing trend with corporate profits recording a historically high level. Regarding the household sector, members shared the view that private consumption had increased its resilience against the background of steady improvement in the employment and income situation. One member noted that the economy was in the process of shifting from one in which growth was led by external demand to one with more self-sustaining growth that was accompanied by an improvement in domestic demand. This member continued that economic expansion had been spreading across industries, firm sizes, and regions. The member further added that the labor force participation rate and labor productivity had risen, partly reflecting efforts by firms and the government, and thus Japan's economy had been growing in a well-balanced manner, with both the supply and demand sides improving. In relation to this, a different member pointed out that the growth rate in labor productivity in Japan after the introduction of QQE was higher than that during the 10 years before its introduction and that in major economies. In addition, one member expressed the view that, if firms' internal reserves were accumulated excessively, the economy as a whole would have excess savings and the natural rate of interest could decline. This member continued that it was therefore important that the allocation of firms' funds to savings, investment, and employees be well balanced.

Members shared the recognition that exports had been on an increasing trend on the back of the growth in overseas economies. One member, noting that exports for the April-June quarter of 2017 had decreased slightly on a quarter-on-quarter basis but had increased firmly again for the July-September quarter, expressed the view that no change had been observed in the increasing trend in exports as a whole, driven mainly by IT-related goods and capital goods. As for the outlook, members 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 on the back of the growth in overseas economies.

Members shared the view that public investment had been increasing due to the implementation of the set of stimulus measures formulated in fiscal 2016, and that it was likely to remain more or less flat at a high level.

Members shared the recognition that business fixed investment had been on a moderate increasing trend with corporate profits improving. Regarding the outlook, they agreed that it was likely to continue increasing moderately, mainly on the back of accommodative financial conditions and heightened growth expectations. Meanwhile, one member expressed the view that, given the prolonged decline in the proportion of firms' fixed investment to operating cash flow, their investment stance had not yet become sufficiently vigorous.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to tighten steadily and employee income had increased moderately. One member pointed out that labor market conditions had tightened further recently, as evidenced by steady increases in the active job openings-to-applicants ratio and the new job openings-to-applicants ratio, both exceeding the peak levels observed during the bubble period, and by a decline in the unemployment rate to the range of 2.5-3.0 percent.

Members shared the recognition that private consumption had increased its resilience against the background of steady improvement in the employment and income situation. One member expressed the view that the firmness in private consumption, despite the bad weather conditions in summer 2017, to some extent reflected the improvement in consumer sentiment resulting mainly from the recent high stock prices. In the outlook, members agreed that private consumption was likely to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as replacement demand for durable goods. Meanwhile, one member noted that, since the consumption tax hike in 2014, real consumption had not risen sufficiently despite the increase in real disposable income. As background to this, the member pointed to the possibility that households' concern about a decline in their future income had materialized because of the consumption tax hike.

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

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

As for prices, members concurred that the year-on-year rate of change in the CPI (all items less fresh food) was in the range of 0.5-1.0 percent, while the rate of change for all items less fresh food and energy remained slightly positive, partly as price rises by firms continued to be limited. They shared the recognition that these relatively weak developments in prices were attributable to the fact that the mindset and behavior based on the assumption that wages and prices would not increase easily had been deeply entrenched among firms and households, as well as to temporary factors such as reductions in prices of and charges for mobile phones. Meanwhile, members agreed that inflation expectations remained in a weakening phase, although some indicators showed an uptrend in such expectations, after having hit bottom around summer 2016.

B. Outlook for Economic Activity and Prices

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

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

2014, when the last consumption tax hike took place, these effects were highly uncertain and varied depending, for example, on the income situation and price developments.

In relation to the effects of economic activity on prices, members discussed the point that prices continued to show relatively weak developments despite the steady tightening of labor market conditions. They shared the recognition that firms' wage- and price-setting stance had been affected by the fact that the mindset and behavior based on the assumption that wages and prices would not increase easily had been deeply entrenched among firms and households. Many members pointed out that such a stance was evidenced by the fact that many firms had limited wage increases that corresponded to the labor shortage mainly to wages of part-time employees, and that, as a result, wage increases for regular employees had been lagging behind those for part-time employees. Many members said that an increasing number of firms had been making efforts to increase labor-saving investment that took advantage of IT and to streamline their business processes -- for example, by discontinuing business late at night -- in order to absorb the rise in labor costs and avoid raising output prices. One member added that such efforts by firms were partly reflected in small firms' software investment plans for fiscal 2017 in the September 2017 *Tankan*, which had marked a significant increase of more than 20 percent on a year-on-year basis.

Members then discussed the fact that firms' wage- and price-setting stance had been changing. Most members shared the recognition that the upward pressure on prices stemming from the rise in firms' costs had been increasing steadily, partly due to a continued clear uptrend in hourly scheduled cash earnings of part-time employees and a rise in input prices resulting from the past yen depreciation. One member noted that hourly scheduled cash earnings of part-time employees such as those at convenience stores and in the food service industry had reached record highs, and those of temporary workers related to nursing care had started to increase. This member continued that the current phase was one in which wage increases for regular employees were awaited, and that developments in the annual labor-management wage negotiations to be held in spring 2018 deserved close attention. With regard to firms' price-setting stance, one member pointed out that, in a situation where an increasing number of firms were beginning to raise prices, due mainly to labor shortages, there were cases where the profitability of firms in some industries -- such as food services as well as beer and related beverages -- had improved owing to price increases, and that this had led to rises in their stock prices. A different member expressed the view that consumers' acceptance of price increases had been growing gradually with the improvement in the employment and income situation. In relation to these views, one member said that, given that many firms in Japan had raised prices for the first time in more than two decades, in order to change the social norm toward a rise in inflation, it was important for firms to accumulate experience from raising prices and develop expertise that would help in terms of making consumers accept such price increases.

Some members pointed out that the increase in the labor force participation rate as well as firms' efforts to raise productivity -- for example, through labor-saving investment -- would lead to restraining prices in the short term, but in the somewhat longer term would raise the economy's growth potential and at the same time contribute to pushing up prices -- for example, through a rise in firms' expected profits. One member pointed out that an environment was already in place in which firms were able to dramatically raise productivity by proactively increasing investment in physical and human capital. This member added that achievement of the 2 percent price stability target would come into sight as improved productivity brought about a sustainable increase in real employee income, leading to the start of a rise in private consumption.

In response to these discussions, one member pointed out that, despite the continued aging of the population, there was still excess supply capacity in the labor market given the remaining room for improvement in the employment rate for men, in addition to an increase in women's participation in the labor force. This member expressed the view that, as long as this situation continued, it was unlikely that wage increases brought about by the tightness in the labor market would fully take hold. In response to this, one member said that, when examining the effects of additional labor supply on wages and prices, it was necessary to take into account the demographic situation in Japan as a whole, with the working-age population decreasing by around 0.5 to 1 million people every year. A different member expressed the recognition that, since it was very likely that the upper limit of the labor force participation rate was declining due to structural factors reflecting the continued aging of the population, the rise in this rate would peak out in due course, and thus the restraining pressure on a rise in wages and prices eventually would wane.

Members exchanged views regarding the outlook for prices. Most members shared the view that, although the year-on-year rate of increase in the CPI had been relatively sluggish recently, the rate of change was likely to continue on an uptrend and increase toward 2 percent, mainly on the back of the improvement in the output gap and the rise in medium- to long-term inflation expectations. These members agreed that, comparing the current projections with those presented in the July Outlook Report, the projected rate of increase in the CPI for fiscal 2017 was somewhat lower, due mainly to the effects of a reduction in charges for mobile phones, but that the rates of increase for fiscal 2018 and 2019 were more or less unchanged. On this basis, they shared the recognition that the timing of the year-on-year rate of change in the CPI reaching around 2 percent would likely be around fiscal 2019. Meanwhile, one member expressed the view that there was still a long way to go before the price stability target of 2 percent was achieved in Japan because there remained excess supply capacity in capital stock and the labor market.

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

Members also discussed <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 three upside and downside risk factors: (1) developments in overseas economies; (2) firms' and households' medium- to long-term growth expectations; and (3) fiscal sustainability in the medium to long term. A few members expressed the view that, among these factors, downside risks to developments in overseas economies appeared to be waning on the whole, as emerging economies had become firm and the uncertainty regarding such issues as those concerning the financial sector in Europe had lessened. A few members added that central banks in the United States and Europe continued to engage in careful communication with regard to the normalization of their monetary policies, and that this had been contributing to the decrease in uncertainty in global financial markets. On this basis, members concurred that, with regard to the outlook for economic activity, upside and downside risks were generally balanced.

As for upside and downside risks to prices, members pointed to the following three factors: (1) developments in firms' and households' medium- to long-term inflation expectations; (2) the fact that there were items for which prices were not particularly responsive to the output gap; and (3) developments in foreign exchange rates and international commodity prices going forward. With regard to the first factor, they agreed that there was a risk that a rise in inflation expectations would lag behind if it took time for firms' stance to shift toward raising wages and prices and inflation consequently remained relatively sluggish. In addition, members shared the view that, with regard to goods and services that were difficult to differentiate, their prices might also constrain the acceleration of inflation if competition among firms intensified further, due mainly to changes in the distribution system and deregulation. On this point, one member pointed to the possibility that, against the background of severe price competition among firms, falling mobile-phone related prices might not be a temporary phenomenon but could become a continuous factor that would exert downward pressure on prices for a relatively long term. On this basis, members shared the recognition that, regarding the outlook for prices, risks were skewed to the downside, especially those concerning developments in medium- to long-term inflation expectations.

III. Summary of Discussions on Monetary Policy for the Immediate Future

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

With regard to conducting monetary policy, most members shared the recognition that, although it was necessary to carefully examine the fact that firms' wage- and price-setting stance remained cautious, the momentum toward achieving the 2 percent price stability target was being maintained. As background to this, these members noted the following two points: (1) firms' stance was likely to gradually shift toward raising wages and prices with the steady improvement in the output gap, and (2) indicators of medium- to long-term inflation expectations had stopped declining, with some indicators showing an uptrend, and such inflation expectations were likely to rise steadily as further price rises came to be observed widely.

Following this discussion, most members shared the recognition that it was appropriate for the Bank to persistently pursue powerful monetary easing under the current guideline for market operations, and that additional easing measures should not be implemented at this point. One member expressed the opinion that the Bank should continue with the current monetary easing with the aim of persistently encouraging the virtuous cycle of the economy -- in which a sustainable increase in demand led to improvement in the income situation -- to take hold and completely overcoming deflation. A few members were of the view that the current monetary policy framework incorporated a mechanism in which the effects of accommodative monetary policy would be enhanced through a decline in real interest rates and a rise in the natural rate of interest, with inflation expectations and the potential growth rate rising. These members continued that it therefore was possible to enhance momentum toward achieving 2 percent by maintaining the current guideline for market operations. A different member expressed the view that the current monetary easing policy was the most appropriate policy from the standpoint of providing an environment where firms could work on improving productivity continuously. Another member expressed the view that the level of the current yield curve in real terms was substantially below that of the natural yield curve for all maturities, and was already sufficiently accommodative even compared with past monetary easing phases, and that additional easing measures were therefore unnecessary. A few members said that, if the Bank took extreme monetary easing measures only for the purpose of hastening to achieve the price stability target, side effects such as an accumulation of financial imbalances and an impaired functioning of financial intermediation could arise, consequently preventing monetary accommodation from producing the intended policy effects to a sufficient degree. In response to such views, one member argued that, in a situation where it was likely that excess supply capacity remained in both capital stock and the labor market, and considering that a consumption tax hike was scheduled for 2019, the Bank should implement additional easing measures at this moment, thereby raising the probability of achieving the price stability target earlier.

Another member said that, although some market participants argued that the Bank should head toward a so-called exit from its current monetary policy along with central banks in the United States and Europe, it would be no wonder if the Bank was late in doing so given that monetary easing in Japan had started later than in those other countries. This member also said that there was no need for concern regarding deterioration in the Bank's profits in its exit phase. As reasons for this, the member pointed out that, in the process of monetary easing, the Bank's payment to the national treasury had increased, reflecting a rise in the Bank's profits, and the government's tax revenue increased, thereby reducing the ratio of fiscal deficit to nominal GDP. The member continued that in the long run, even after an exit, the Bank's profits were expected to increase along with the rise in interest rates.

With respect to yield curve control, members shared the recognition that, since the previous meeting, the JGB yield curve had been formed smoothly in a manner consistent with the guideline for market operations. One member noted that, although market participants' assessment was that short- and long-term interest rates were very well controlled, in the Bank's daily conduct of market operations, further attention should be paid not only to liquidity in the JGB market but also to domestic and foreign investors' attitude toward investment, as well as the securities portfolios held by financial institutions.

Based on the above discussions, regarding the guideline for market operations for the intermeeting period, most members expressed the view that it was appropriate for the Bank to maintain the following guideline. First, as for the short-term policy interest rate, it would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, as for the long-term interest rate, the Bank would purchase JGBs so that 10-year JGB yields would remain at around 0 percent. With regard to the amount of JGBs to be purchased, it would conduct purchases at more or less the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline.

On this point, one member expressed the opinion that, with a view to lowering interest rates with longer maturities, it was appropriate for the Bank to purchase JGBs so that 15-year JGB yields would remain at less than 0.2 percent instead of targeting 10-year JGB yields.

In response to this member's opinion, some members pointed out that the specific policy effects on Japan's economy and prices, as well as the mechanism to bring about such effects, were unclear when the Bank lowered 15-year JGB yields. On this point, a different member expressed concern that a lowering of yields on JGBs with super-long maturities, such as 15-year JGBs, would negatively affect public sentiment, mainly through the fall in the rates of return on investments by insurance companies and pension funds.

With regard to asset purchases other than JGB purchases, members shared the recognition that it was appropriate for the Bank to implement the following guideline for the intermeeting period. First, it would purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. Second, as for CP and corporate bonds, it would maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively. One member said that, while some market participants were speculating that the Bank would accelerate the pace of ETF purchases toward the year-end in order to achieve the target for the annual pace of increase in the amount outstanding of ETF holdings, such a view was not appropriate. This member noted that the Bank had been purchasing ETFs with a view to influencing risk premia in the stock market. The member added that the actual amount of such purchases varied depending on market conditions, and the Bank had not set a specific time by which to achieve the target for the amount outstanding of ETF holdings. A different member said that the policy effects and the possible side effects of the purchases of risky assets including ETFs should be examined from every angle, even if market functioning was not significantly affected by such purchases at this point.

With respect to the Bank's thinking behind its future conduct of monetary policy, most members shared the view that the Bank would (1) continue with QQE with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining that target in a stable manner, (2) continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeded 2 percent and stayed above the target in a stable manner, and (3) make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target.

In response to this, one member said that, with a view to reinforcing the inflation-overshooting commitment, it was appropriate for the Bank to introduce a new commitment that it would take additional easing measures if -- with regard to the median of the Policy Board members' forecasts of the CPI in the Outlook Report -- there was a delay in the timing of achieving the price stability target due to domestic factors. On this point, a different member expressed the opinion that it was unnecessary for the Bank to make a new commitment as it already had in place the commitment that it would 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.

IV. Remarks by Government Representatives

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

(1) In order to overcome the most critical issue of the declining birth rate and aging society and realize sustainable economic growth, the government would work to formulate a new economic policy package by the end of 2017 to achieve "Supply System Innovation" and "Human Resources Development," the latter of which would utilize such financial resources as increased revenue from the scheduled consumption tax hike.

(2) Meanwhile, the government would not lower the flag of fiscal consolidation; with the aim of attaining a surplus in the primary balance, it would continue to undertake reforms from both the expenditure and revenue sides and draw up a concrete plan for achieving this.

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

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on a moderate recovery. As for the outlook, it was expected to recover moderately, supported partly by the effects of the government's policies, while the employment and income situation continued to improve. However, attention

should be given to the uncertainty in overseas economies and the effects of volatility in financial markets. In assessing price developments, it was important to comprehensively examine a wide range of price indicators, including the GDP deflator.

(2) The greatest challenge for the Japanese economy was to raise the potential growth rate through supply-side reforms, and to this end, the government had set "Human Resources Development" and "Supply System Innovation" as major pillars of its economic policies. It would work to formulate a new economic policy package by the end of 2017 to specify the measures that these two pillars would entail, and swiftly implement the measures, starting with those that were ready.

(3) The government expected the Bank to steadily work toward achieving the price stability target of 2 percent, in light of developments in economic activity and prices, as well as financial conditions. It also expected the Bank to continue to fully explain the situation of its monetary policy management and the outlook for prices at the Council on Economic and Fiscal Policy and on other occasions.

V. Votes

A. Vote on the Guideline for Market Operations

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

The Policy Board decided the proposal by a majority vote.

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

The guideline for market operations for the intermeeting period will be as follows.

1. The Bank will apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank.

2. The Bank will purchase JGBs so that 10-year JGB yields will remain at around zero percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases at more or less the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion

yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline.

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

Votes against the proposal: Mr. G. Kataoka.

Mr. G. Kataoka dissented, considering that, with a view to lowering the interest rates with longer maturities of the yield curve, it was appropriate for the Bank to purchase JGBs so that 15-year JGB yields would remain at less than 0.2 percent.

B. Vote on the Guideline for Asset Purchases

To reflect the view of the members, the chairman formulated the following proposal to implement the guideline for asset purchases for the intermeeting period and put it to a vote: (1) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively, and (2) to maintain the amounts outstanding of CP and corporate bonds at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

The Policy Board decided the proposal by a unanimous vote.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, Mr. H. Suzuki, and Mr. G. Kataoka.

Votes against the proposal: None.

C. Vote on the Statement on Monetary Policy

On the basis of the above results of votes, members discussed the Statement on Monetary Policy. With a view to reinforcing the inflation-overshooting commitment, Mr. G. Kataoka expressed the opinion that, if there was a delay in the timing of achieving the price stability target due to domestic factors, the Bank should take additional easing measures, and that it was necessary to include that in the policy statement.

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

VI. Discussion regarding the Outlook Report

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

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

The Policy Board decided the text of "The Bank's View" by a majority vote. It was confirmed that "The Bank's View" would be released immediately after the meeting on October 31, 2017 and the whole report would be made public on November 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 from 2018 onward was low at this point.

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

Votes against the proposal: Mr. G. Kataoka.

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of September 20 and 21, 2017 for release on November 6.

Attachment
October 31, 2017
Bank of Japan

Statement on Monetary Policy

At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided upon the following. [Note 1]

(1) Yield curve control

The Bank decided, by an 8-1 majority vote, to set the following guideline for market operations for the intermeeting period. [Note 2]

The short-term policy interest rate:

The Bank will apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank.

The long-term interest rate:

The Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain at around zero percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases at more or less the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline.

(2) Guidelines for asset purchases

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

a) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively.

b) As for CP and corporate bonds, the Bank will maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

[Note 1] With a view to reinforcing the inflation-overshooting commitment, Mr. G. Kataoka dissented from the decision, considering that, if there was a delay in the timing of achieving the price stability target due to domestic factors, the Bank should take additional easing measures and that it was necessary to include that in the text.

[Note 2] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki. Voting against the action: Mr. G. Kataoka. Mr. G. Kataoka dissented, considering that, with a view to lowering the interest rates with longer maturities of the yield curve, it was appropriate for the Bank to purchase JGBs so that 15-year JGB yields would remain at less than 0.2 percent.