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November 5, 2018

Bank of Japan

Minutes of the Monetary Policy Meeting

on September 18 and 19, 2018

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Tuesday, September 18, 2018, from 2:00 p.m. to 3:36 p.m., and on Wednesday, September 19, from 9:00 a.m. to 11:40 a.m.[1]

Policy Board Members Present

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

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

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

Mr. Y. Harada

Mr. Y. Funo

Mr. M. Sakurai

Ms. T. Masai

Mr. H. Suzuki

Mr. G. Kataoka

Government Representatives Present

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

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

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

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

Reporting Staff

Mr. E. Maeda, Executive Director

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

Mr. Y. Ikeda, Executive Director

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 October 30 and 31, 2018 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. M. Kihara and T. Ochi were present on September 19.

[3] Messrs. E. Chatani and A. Nakamura were present on September 18.

Mr. Y. Nakaone, Deputy Director-General, Monetary Affairs Department[4]

Mr. A. Okuno, Head of Policy Planning Division, Monetary Affairs Department

Mr. S. Shimizu, Director-General, Financial Markets Department

Mr. T. Sekine, Director-General, Research and Statistics Department

Mr. H. Ichiue, Head of Economic Research Division, Research and Statistics Department

Mr. Y. Nakata, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. Y. Onozawa, Director-General, Secretariat of the Policy Board

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

Mr. K. Iijima, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

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

Mr. M. Higashi, Senior Economist, Monetary Affairs Department

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[4] Messrs. Y. Nakaone and K. Iijima were present on September 18 from 2:45 p.m. to 3:36 p.m.

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

A. Market Operations in the Intermeeting Period

The Bank, in accordance with the short-term policy interest rate of minus 0.1 percent and the target level of the long-term interest rate, both decided at the previous meeting on July 30 and 31, 2018, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[6] In this situation, 10-year JGB yields had been at around 0 percent, and the shape of the JGB yield curve had been consistent with the guideline for market operations.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had been generally in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.05 to minus 0.07 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had generally been more or less unchanged at around minus 0.15 percent.

The Nikkei 225 Stock Average had been generally unchanged despite mostly favorable corporate earnings, as uncertainties over trade policy, especially between the United States and China, had depressed stock prices. In the foreign exchange market, the yen had appreciated temporarily somewhat against both the U.S. dollar and the euro when the Turkish lira plunged, but had been more or less flat throughout the intermeeting period.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow firmly on the whole, and were likely to maintain their firm growth.

The U.S. economy had been expanding. Exports had been on an increasing trend. Private consumption had been on an uptrend, supported in part by a favorable employment

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

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

The Bank will purchase JGBs so that 10-year JGB yields will remain at around zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

and income situation and consumer sentiment. Meanwhile, business fixed investment had been increasing firmly, mainly on the back of improvements in corporate profits and business sentiment. As for prices, the year-on-year rate of change in the personal consumption expenditure (PCE) deflator for all items had been in the range of 2.0-2.5 percent and that for all items excluding food and energy had been at around 2 percent. The economy was likely to continue to expand, underpinned by expansionary fiscal measures.

The European economy continued to recover, albeit at a somewhat slower pace. Growth in exports had been decelerating, mainly reflecting past appreciation of the euro. Private consumption had been on an increasing trend, partly supported by a favorable employment and income situation and consumer sentiment, and business fixed investment also had been on such a trend. With regard to prices, the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items had been at around 2 percent and that for all items excluding energy, food, alcohol, and tobacco had been at around 1 percent. The European economy was likely to continue its recovery. Meanwhile, economic activity in the United Kingdom had been on a moderate recovery trend with the calm inflation rate.

With regard to emerging economies, the Chinese economy continued to see stable growth on the whole. As for prices, the year-on-year rate of change in the consumer price index (CPI) had been at around 2 percent. The economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policies in a timely manner. In the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports being on an increasing trend. Economic activity in Russia and Brazil had been recovering moderately, mainly on the back of stable inflation rates. In India, the economy had been recovering moderately, particularly in domestic demand.

With respect to overseas financial markets, stock prices, among other factors, had fluctuated somewhat mainly against the backdrop of uncertainties over trade policy, especially between the United States and China, and of the depreciation of some emerging economies' currencies induced by the plunge of the Turkish lira. Nevertheless, currencies of Asian emerging economies had been stable on the whole, and capital outflows from emerging economies as a whole had been limited. In the commodity market, crude oil prices had risen amid concern in particular over geopolitical risks in the Middle East.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy was expanding moderately, with a virtuous cycle from income to spending operating, and was likely to continue its moderate expansion.

Exports had been on an increasing trend on the back of the firm growth in overseas economies. Those to advanced economies continued on their increasing trend, and those to emerging economies had picked up for a wide range of items. Exports, mainly of IT-related goods and capital goods, were expected to continue on their moderate increasing trend.

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

Business fixed investment continued on an increasing trend with corporate profits and business sentiment maintaining their improving trend. Looking at the *Financial Statements Statistics of Corporations by Industry, Quarterly*, the ratio of current profits to sales for the April-June quarter of 2018 had risen significantly and had marked a historical high, due mainly to a temporary increase in non-operating income of large manufacturers. According to the second preliminary estimates of GDP for the April-June quarter, the growth rate of real business fixed investment had marked 3.1 percent on a quarter-on-quarter basis, representing a seventh consecutive quarterly increase. Machinery orders and construction starts in terms of planned expenses for private nondwelling construction -- both of which were leading indicators of business fixed investment -- continued on an increasing trend, albeit with monthly fluctuations. Business fixed investment was likely to continue increasing for the time being, mainly on the back of an improvement in corporate profits and accommodative financial conditions.

As for the employment and income situation, supply-demand conditions in the labor market continued to tighten steadily, and the pace of increase in employee income had accelerated recently. The active job openings-to-applicants ratio had been rising at a high level that exceeded the peak marked during the bubble period, and the unemployment rate continued to be at a low level.

Private consumption had been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. The consumption activity index (CAI; real, travel balance adjusted) -- calculated by combining various sales and supply-side statistics -- had increased for the April-June quarter on a quarter-on-quarter basis and had risen slightly for July relative to that quarter. 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 by replacement demand for durable goods.

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

Industrial production had been on an increasing trend against the background of rises in demand at home and abroad. It was likely to continue to increase firmly for the time being on the back of these rises.

As for prices, the producer price index (PPI) relative to three months earlier -- adjusted for the effects of seasonal changes in electricity rates -- had been rising, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the CPI for all items less fresh food was in the range of 0.5-1.0 percent, and that for all items less fresh food and energy was in the range of 0.0-0.5 percent recently. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising.

2. Financial environment

Financial conditions were highly accommodative.

Inflation expectations had been more or less unchanged. Long-term real interest rates -- calculated as long-term interest rates minus medium- to long-term inflation expectations -- had been negative.

Firms' funding costs had been hovering at extremely low levels. With regard to credit supply, financial institutions' lending attitudes -- as perceived by firms -- had been highly accommodative. Issuing conditions for CP and corporate bonds had been favorable. Firms' credit demand, such as for funds for business fixed investment, had been increasing. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been at around 2 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds had been at a relatively high level. Firms' financial positions had been favorable.

The monetary base had been increasing at a year-on-year growth rate of around 7 percent. The year-on-year rate of growth in the money stock had been at around 3 percent.

II. Treatment of Newly Eligible Institutions under the Special Rules regarding Complementary Deposit Facility

A. Staff Reports

With the aim of facilitating a smooth operation of the complementary deposit facility, the staff proposed that the Bank establish Special Rules regarding Calculation of Interest of Complementary Deposit Facility for New Institutions and make relevant changes, in order to develop a framework that would allot an amount of Macro Add-on Balances to institutions that had become or would become eligible for the complementary deposit facility during or after the January 2016 reserve maintenance period.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve "Establishment of 'Special Rules regarding Calculation of Interest of Complementary Deposit Facility for New Institutions.'" They concurred that the staff should accordingly make this public after the meeting.

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

A. Economic Developments

Regarding global financial markets, members shared the recognition that -- mainly against the backdrop of uncertainties over trade policy, especially between the United States and China, and of the depreciation of some emerging economies' currencies induced by the plunge of the Turkish lira -- investors' risk sentiment had worsened and stock prices, among other factors, had fluctuated somewhat. As for the U.S. trade policy, some members pointed to concern that related problems would persist as neither the United States nor China had shown willingness to compromise on their trade relations, although renegotiation of the North American Free Trade Agreement (NAFTA) and negotiations between the United States and the European Union (EU) had progressed. As for market developments surrounding emerging economies, some members expressed the recognition that capital outflows from emerging economies as a whole had been limited to date, as fundamentals had been firm for many of these economies, mainly in Asia. On this basis, a few members added that, as normalization of monetary policy proceeded, such as in the United States, close attention should continue to be paid to whether or not capital outflows would spread to countries other than those with vulnerability in their economies, such as Turkey and Argentina.

With respect to overseas economies, members shared the recognition that they continued to grow firmly on the whole. A few members expressed the view that domestic demand maintained its momentum in many countries and that global trade continued its recovery, albeit at a somewhat slower pace. Nevertheless, one member commented that it was necessary to pay attention to the fact that, although advanced and emerging economies had been growing in a well-balanced manner so far, the contrast between the extremely favorable U.S. economy and other economies was becoming more evident. As for the outlook, members agreed that overseas economies were likely to maintain their firm growth. On this basis, many members expressed the recognition that downside risks to developments in overseas economies, such as sustained protectionist moves and the impact of the rise in U.S. interest rates on emerging economies, continued to increase. One member added that, regarding the effects on the global economy of the trade friction between the United States and China, attention should be paid not only to the direct impact on each country's trade activity, but also to the possibility that these effects would intensify through such indirect channels as the turmoil in global financial markets and the deterioration in business sentiment. In addition, some members said that developments in negotiations on the United Kingdom's exit from the EU, including the likelihood of the so-called no-deal Brexit, and geopolitical risks in such regions as the Middle East could be raised as risks to developments in overseas economies.

With regard to the current situation of overseas economies by region and their outlook, members concurred that the U.S. economy had been expanding. One member expressed the view that business sentiment continued to improve, as shown, for example, by the fact that the Institute for Supply Management (ISM) indices for both manufacturing and nonmanufacturing had risen for August, amid the real GDP growth rate for the April-June quarter accelerating to the range of 4-5 percent on an annualized quarter-on-quarter basis.

As for the outlook, members shared the view that the economy was likely to continue to expand, underpinned mainly by expansionary fiscal measures. One member said that, as private consumption had momentum against the background of the favorable employment situation, the uptrend in the economy was likely to continue for the time being. This member then commented that, from a somewhat long-term perspective, it was necessary to closely examine whether there were signs of an overheating in the economy by carefully monitoring developments in the stock, housing, automobile, and other markets.

Members shared the recognition that the European economy continued to recover, albeit at a somewhat slower pace. One member expressed the view that business fixed investment had been on an uptrend, mainly on the back of improvement in business sentiment, and private consumption had been firm, supported by a favorable employment and income situation. As for the outlook, members concurred that the European economy would likely continue its recovery. One member noted that attention should be paid to the developments in negotiations on the United Kingdom's exit from the EU and the instability of the Turkish economy, but that the progress in trade negotiations between the United States and the EU since summer was a positive factor that would reduce downside risks to the outlook. A different member pointed out that, although the latest figure of the Purchasing Managers' Index (PMI) for services -- that is, for August -- had picked up, the PMI for manufacturing had been on a downtrend since early spring; thus, the member noted that it was necessary to closely monitor whether there were signs of deterioration in the European economy.

Members shared the recognition that emerging economies had been recovering moderately overall. They agreed that the Chinese economy continued to see stable growth on the whole. Members concurred that, in the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports being on an increasing trend. They shared the recognition that commodity-exporting economies had been recovering moderately, mainly on the back of the stable inflation rates. As for the outlook, members agreed that emerging economies were likely to continue their moderate recovery overall. They shared the view that the Chinese economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policies in a timely manner. One member stated that downward pressure on the Chinese economy had been increasing due to the trade friction between the United States and China, and that, depending on the situation, this could negatively affect the Asian economies as a whole. On this point, a different member expressed the view that the raising of tariffs by the United States was becoming a cause for concern regarding trade, but the Chinese authorities had started to take responsive economic stimulus measures, and thus the Chinese economy would likely maintain a growth rate of 6.5-7.0 percent for the time being.

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 agreed that the economy was expanding moderately, with a virtuous cycle from income to spending operating. Many members expressed the recognition that, although the real GDP growth rate temporarily had become negative for the January-March quarter of 2018, the rate for the April-June quarter returned far into positive territory, especially the rates for business fixed investment and private consumption; these members continued that the economy overall remained on an expanding trend driven by domestic demand.

As for the outlook for the economy, members concurred that it was likely to continue its moderate expansion. On a more specific note, they shared the recognition that domestic demand was likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. Regarding the effects of this summer's successive natural disasters on the economy, many members -- based on the information gained so far -- pointed out that, while the effects on production and supply chains were limited, those on tourism were evidenced, for example, by cancellations of reservations and a decline in the number of new reservations even in areas with only slight direct damage. On this basis, these members stated that, although the effects of these natural disasters were not grave enough to require a revision of the Bank's principal outlook for the economy at this point, it was important to continue gathering information thoroughly on the effects, including those of harmful rumors, on inbound demand and consumer sentiment. Meanwhile, one member expected that firms' implementation of structural measures, such as making use of a variety of human resources as well as making labor-saving investment, would progress with appropriately tightened supply-demand conditions continuing going forward, and that such progress would lead to an increase in household income and an expansion in consumption. A different member stated that, in order to effectively achieve economic growth, it was necessary for firms to cut back jobs with low productivity and profitability, and that in order to mitigate employment problems arising from such cutbacks, it was important to tighten labor market conditions through monetary easing. On this basis, the member pointed out that the rate of increase in labor productivity per hour had been rising under Quantitative and Qualitative Monetary Easing (QQE), and noted that the rate of growth in productivity for the existing workers was possibly rising to a greater extent than the figures observed on a macro basis, considering that the workers who were newly employed during this period largely consisted of those who were thought to be relatively less productive, such as workers with little experience. One member stated that, while it was likely that there would be downward pressure on the potential growth rate and the natural rate of interest in Japan coupled with the progress in the declining birthrate and aging population, an improvement in productivity through a further promotion of technological innovation was necessary, and this would enhance monetary easing effects.

Regarding recent developments in exports, members shared the recognition that they had been on an increasing trend on the back of the firm growth in overseas economies, although the impact of temporary declines in production due to the heavy rain this summer was observed. As for the outlook, they concurred that exports would likely continue on their moderate increasing trend for the time being on the back of the firm growth in overseas economies. On this basis, a few members expressed the view that, although exports were likely to maintain their moderate growth for the time being, uncertainties over future developments such as the effects of the trade friction between the United States and China had heightened.

Members agreed that public investment had been more or less flat, remaining at a relatively high level. A few members expressed the recognition that, in addition to Olympic Games-related construction, various types of construction relating to restoration following this summer's natural disasters would underpin future public investment.

Members concurred that business fixed investment continued on an increasing trend with corporate profits and business sentiment maintaining their improving trend. As an indicator supporting this recognition, many members pointed out that business fixed investment in the second preliminary estimates of GDP for the April-June quarter had been revised substantially upward from its first preliminary figure, with fixed investment for both manufacturing and nonmanufacturing increasing significantly on a quarter-on-quarter basis. One member expressed the recognition that fixed investment continued to show somewhat stronger growth than expected, in a situation where an improvement in corporate profits and highly accommodative financial conditions had been maintained. A different member pointed out that labor shortage caused by powerful monetary easing had boosted investment aimed at saving labor and improving business efficiency. Regarding the outlook, members agreed that business fixed investment was likely to continue increasing, mainly on the back of an improvement in corporate profits, accommodative financial conditions, and heightened growth expectations. One member commented that, in order to avoid a potential cyclical decline in business fixed investment as much as possible, it was important that firms' expectations for economic growth rise. On this point, one member said that it was worth paying attention to whether the recent heightened growth in investment intended for domestic capacity expansion and in research and development was attributable to a heightening in growth expectations.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to tighten steadily, and that the pace of increase in employee income had accelerated recently. Some members noted that the continued tightening in labor market conditions was evidenced, for example, by the fact that the active job openings-to-applicants ratio had been rising at a level that exceeded the peak marked during the bubble period, while the unemployment rate remained at a low level of around 2.5 percent. A few members expressed the view that, given that the rate of increase in wages of regular employees was relatively low compared with that of part-time employees, there was a possibility that labor slack remained in the back-office division of some industries relative to the field-site division where labor shortage had been intensifying.

Members shared the recognition that private consumption had been increasing moderately, albeit with fluctuations. In the outlook, they concurred that private consumption was likely to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as by replacement demand for durable goods. Some members said that private consumption had been firm recently against the backdrop of steady improvement in the employment and income situation, as seen, for example, in the fact that the quarter-on-quarter growth in private consumption in terms of real GDP had turned positive in the April-June quarter from a negative figure in the January-March quarter, and that the CAI had increased for the April-June quarter on a quarter-on-quarter basis and had risen for July relative to that quarter. Meanwhile, a different member expressed the recognition that, while consumption of durable goods and services had been increasing, albeit with fluctuations, that of non-durable goods including food, beverages, and clothes continued to be sluggish; therefore, vulnerability remained in private consumption.

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

Members shared the view that industrial production had been on an increasing trend against the background of rises in demand at home and abroad. Regarding the outlook, they agreed that industrial production was likely to continue to increase firmly for the time being on the back of these rises. On this basis, a few members said that it was somewhat difficult to project at present whether production, which had temporarily decreased due to this summer's natural disasters, would fully recover in the latter half of 2018.

As for prices, members concurred that the year-on-year rate of change in the CPI for all items less fresh food was in the range of 0.5-1.0 percent, and the rate of increase in the CPI for all items less fresh food and energy remained in the range of 0.0-0.5 percent, due partly to firms' cautious wage- and price-setting stance. On this basis, they shared the recognition that, taking account of the recent underlying trend in the CPI, the year-on-year rate of change in the CPI continued to show relatively weak developments compared to the economic expansion and the labor market tightening.

In terms of the outlook for prices, most members shared the view that the year-on-year rate of change in the CPI was likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising. One member pointed out that the recent pause in the deceleration in prices of goods, which was partly due to the effects of the yen's appreciation through early spring dissipating, and the significant increase in summer bonuses were positive developments for an improvement in prices. One member expressed the recognition that, as there was a limit to a rise in the labor force participation rate and to effective labor-saving investment, continuance of labor shortage eventually would lead to wage increases. On this basis, the member pointed out that the recent rate of increase for wages shown in statistics was said to be higher than in reality, but in fact, wages were increasing even when discounting the rate in the statistics. This member also pointed out that an expansion in employee income brought about by rises in wages and the number of employees would exert upward pressure on prices through increases in both demand and costs. Meanwhile, a few members said that, if labor supply of seniors -- whose wage elasticity was high -- was maintained, this could continue to be a factor that constrained wage and price increases overall. One of these members added that the spread of the use of the internet and smartphones, as well as the heightening of seniors' digital literacy, had been promoting labor participation by seniors through the improvement in their ability to gather information, and that such developments might not be only temporary. In relation to this, one member said that it was gradually becoming clear that the delay in a rise in inflation was due not only to a mere demand shortage, but also to various factors such as (1) people's persistent deflationary mindset and (2) the constraining effects of inflation accompanying the rise in the labor force participation rate as well as the improvement in productivity brought about by labor-saving investment. The member continued that, therefore, uncertainties regarding the outlook for prices had been heightening. A different member pointed out that, given that the adaptive formation mechanism of inflation expectations played a large role in Japan, it could not be ignored when examining future price developments that items such as administered prices, housing rent, and charges for mobile phone services -- all of which have large weights in the CPI -- were hardly responsive to the output gap. Based on these discussions, some members expressed the recognition that the inflation momentum stemming from an improvement in the output gap had been maintained, but it would still take time to change people's perception of prices and thereby cause a marked upward shift in the Phillips curve accompanied by a rise in inflation expectations.

Meanwhile, members agreed that inflation expectations had been more or less unchanged. Most members shared the recognition that, although short-term inflation expectations had risen somewhat, it was taking time for medium- to long-term inflation expectations to rise, mainly because observed prices continued to exhibit relatively weak developments compared to the improvement in the economic and employment conditions.

B. Financial Developments

Members concurred that financial conditions in Japan were highly accommodative. They shared the view that, under QQE with Yield Curve Control, firms' funding costs had been hovering at extremely low levels and financial institutions' lending attitudes, as perceived by both large and small firms, continued to be active. Meanwhile, one member said that additional demand for loans had been decreasing in the loan market as the amount of firms' internal reserves had been at a record high level. This member then pointed out that it was important to make efforts to encourage firms to create active demand for funds through structural reforms and other measures.

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

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

With regard to conducting monetary policy, most members shared the recognition that, although it was necessary to carefully examine the fact that firms' cautious wage- and price-setting stance and households' cautiousness toward price rises had been persistent, the momentum toward achieving 2 percent inflation was being maintained. As background to this, most members noted that (1) many of the factors that had delayed inflation, such as firms' wage- and price-setting stance, were likely to be resolved gradually with the output gap remaining positive, and (2) medium- to long-term inflation expectations, which had been more or less unchanged recently, were likely to rise gradually as further price rises came to be observed widely.

Members then discussed the Bank's basic stance on conducting monetary policy. Most members shared the recognition that, although it would take time to achieve the 2 percent price stability target, it was appropriate to persistently continue with the powerful monetary easing under the current guideline for market operations as the momentum toward achieving 2 percent inflation was being maintained. Some members expressed the view that, under the current powerful monetary easing, keeping the output gap within positive territory for as long as possible, thereby ensuring that the momentum toward achieving 2 percent inflation would not be lost, would lead to achieving the price stability target at the earliest possible time while securing stability in economic and financial conditions. One member noted that, with the aim of achieving the price stability target, the Bank should continue with the current monetary policy stance and persistently encourage the virtuous cycle of the economy to take hold. A different member pointed out that it was important to persistently maintain highly accommodative financial conditions while carefully examining the positive effects and side effects of the current powerful monetary easing. Counter to these opinions, one member said that, since monetary easing effects could wane over time, in order to achieve the price stability target at an early stage, it was necessary for the Bank to conduct additional monetary easing and thereby, together with the government, support the positive changes in behavior among firms and households, rather than to maintain short- and long-term interest rates at certain levels for a long period.

Members also discussed the measure decided at the Monetary Policy Meeting held in July 2018 to strengthen the framework for continuous powerful monetary easing. One member pointed out that, as seen in generally stable stock prices and foreign exchange rates since the previous meeting, the measure to strengthen the framework, including the introduction of forward guidance for policy rates in July, was being accepted by market participants without causing major confusion. Meanwhile, a few members, including this member, commented that, since there remained views among some market participants that the policy intention of the Bank's measure to strengthen the framework was unclear, it was important to continue to thoroughly explain that the measure was intended to make clearer the Bank's policy stance that it would persistently continue with powerful monetary easing while taking into account its side effects. One member pointed out that, mainly in response to the Bank allowing the long-term yields to move in a more flexible manner -- as part of the measure to strengthen the framework -- the volatility in the JGB market had heightened, and the result of the survey conducted by the Bank of market participants showed that they had regarded the market functioning as having been improving to some extent. That being said, some members, including this member, expressed the view that it was necessary to continue to carefully examine the effects on financial markets of the measure to strengthen the framework, as only about two months had passed since the previous meeting, which included the summer period, when the transaction volume of JGBs is small. One member expressed the view that, considering the Bank's purchase of exchange-traded funds (ETFs) from August through the first half of September, the understanding about the Bank's intention to effectively lower the risk premia by purchasing ETFs in a flexible manner depending on market conditions seemed to have advanced among market participants.

Meanwhile, members deliberated over points to take into account in conducting monetary policy. One member expressed the view that, if the economic condition continued with the output gap being maintained in positive territory, there would be room for the Bank to consider making its monetary policy more flexible in the future with a view to maintaining market functioning while continuing with the current policy framework. However, this member noted that, taking account of uncertainties over prices at present, it was essential for the Bank to continue with the current monetary policy cautiously and persistently while carefully examining developments in financial markets and the financial system. Some members expressed the recognition that, partly because Japanese financial institutions had sufficient capital bases, there was no problem with the functioning of financial intermediation at this stage. These members continued that, however, as developments in profits of financial institutions had a cumulative impact on their financial strength, it was necessary to continue to carefully monitor the effects of the prolonged low-yield environment on such institutions' profits and the functioning of financial intermediation. One of these members noted that, if financial institutions proceeded with taking excessive risks to secure profits and the quality of their risky assets deteriorated, their capital bases would be impaired and the financial intermediation function would weaken, thereby heightening the risk that sustainable economic growth would be hampered. On this basis, the member pointed out that it was important to cautiously examine, from a longer-term perspective, whether or not there were financial imbalances and how the situation would develop. In relation to this, one member expressed the opinion that, since there seemed to be a limit to continuing with large-scale monetary easing for a long period of time when taking into consideration its side effects on the financial front, the time frame for monetary policy should be discussed more among Policy Board members. A different member expressed the view that, although some people argued that the Bank should raise interest rates in order to improve financial institutions' profits, there was a high risk that financial institutions' profits would deteriorate due to an increase in credit costs induced by an economic downturn if only interest rates rose in the current situation. This member continued that it therefore was desirable that interest rates rise in line with price rises and recovery in demand for funds. Based on these discussions, one member pointed out that, in the current complex situation where the economy was expanding steadily but achieving the price stability target of 2 percent was taking time, it was essential to conduct monetary policy by taking account of a variety of developments in a comprehensive manner. The member then noted that it was important to consider the positive effects and side effects of monetary policy in a balanced manner, in order to persistently continue with powerful monetary easing.

Members also discussed the Bank's strategy for communication to the public regarding the conduct of monetary policy. One member noted that, although improvements had been seen in the active job openings-to-applicants ratios in local regions, profits of small firms, and compensation of employees, some people commented that monetary easing effects had not been reaching local economies, small firms, and individuals. This member then commented that it therefore was necessary for the Bank to continue thoroughly explaining to the public its thinking behind the conduct of monetary policy, as well as the policy effects. One member said that, in conducting monetary policy, it was important for the Bank to prepare for a variety of downside risks to economic activity and prices, and that the member placed particular importance on developments in inflation expectations. This member then pointed out that it was necessary for the Bank to constantly improve its communication to the public while referring to various academic research studies, in order to effectively influence people's inflation expectations. One member, noting that there were some cases where the Bank was misunderstood to be thinking that it was enough simply to achieve inflation, expressed the view that maintaining appropriate communication to the public while taking care of such misunderstanding would lead to securing public confidence in the monetary policy and consequently to giving the Bank more flexibility in conducting monetary policy toward achieving 2 percent inflation.

With respect to <u>yield curve control</u>, members shared the recognition that, since the previous meeting, the JGB yield curve had been formed smoothly in a manner consistent with the guideline for market operations.

Based on the above discussions, regarding <u>the guideline for market operations for the intermeeting period</u>, most members expressed the view that it was appropriate for the Bank to maintain the following guideline. First, as for the short-term policy interest rate, it would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, as for the long-term interest rate, the Bank would purchase JGBs so that 10-year JGB yields would remain at around 0 percent. While doing so, the yields might move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, it would conduct purchases in a flexible manner so that their amount outstanding would increase at an annual pace of about 80 trillion yen.

On this point, one member expressed the opinion that, since allowing the long-term yields to move upward and downward to some extent was ambiguous as the guideline for market operations decided by the Policy Board, these yields could rise more than necessary, depending on the Bank's conduct of market operations, which could hamper the intended effects of the current yield curve control. A different member was of the opinion that, taking account of, for example, the current price developments, the Bank should strengthen monetary easing at this point, in order to achieve the price stability target of 2 percent at the earliest possible time. The member continued that it was appropriate for the Bank to purchase JGBs so that yields on JGBs with maturities of 10 years and longer would be lowered further.

With regard to asset purchases other than JGB purchases, members shared the recognition that it was appropriate for the Bank to implement the following guideline for the intermeeting period. First, it would purchase ETFs and 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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions. Second, as for CP and corporate bonds, it would maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

With respect to the Bank's thinking behind its future conduct of monetary policy, most members shared the view that it would (1) continue with QQE with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining that target in a stable manner, (2) continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeded 2 percent and stayed above the target in a stable manner, (3) as for policy rates, maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019, and (4) examine the risks considered most relevant to the conduct of monetary policy and make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target.

On this point, one member noted that, as for policy rates, it was more desirable to introduce forward guidance that further clarified its relationship with the price stability target. A different member said that -- with a view to reinforcing the inflation-overshooting commitment and achieving the price stability target of 2 percent at the earliest possible time -- it was necessary for the Bank to add a commitment that it would take some sort of additional monetary easing measures if the Bank revised downward its assessment of medium- to long-term inflation expectations.

V. Remarks by Government Representatives

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

(1) With regard to the recent 2018 Typhoon No. 21 and 2018 Hokkaido Eastern Iburi Earthquake, the government and relevant organizations had been making efforts in unity to provide support for those affected and take emergency response and recovery measures. Moreover, they had been devoting their utmost efforts to swiftly restoring critical infrastructure. As Japan's fiscal authority, the Ministry of Finance would continue to take necessary fiscal policy measures while working closely with the related ministries and agencies.

(2) The application of budget requests for fiscal 2019 was closed on August 31, 2018, and the government would proceed with the budget formulation toward the year-end. This would be the budget to be formulated for the first fiscal year under the New Plan to Advance Economic and Fiscal Revitalization, and the government would continue to firmly undertake full-fledged expenditure reforms.

(3) In view of the consumption tax hike scheduled to take place in October 2019, creating economic conditions that allowed for the hike was important. The government would thoroughly consider specific measures, such as those against possible fluctuations in demand accompanying the tax hike, during the process of budget formulation.

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

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was recovering at a moderate pace. The second preliminary estimate of the real GDP growth rate for the April-June quarter of 2018 was 0.7 percent on a quarter-on-quarter basis and 3.0 percent on an annualized basis, registering positive growth for the first time in two quarters; the nominal GDP marked a record high of 552.8 trillion yen. The economic growth had been supported by an increase in private demand, as seen, for example, in the fact that private consumption had turned positive for the first time in two quarters and private nonresidential investment marked the highest growth after the January-March quarter of 2015.

(2) As for risks to the outlook, attention should be given to the effects of situations over trade issues on the world economy, the uncertainties regarding overseas economies, and the effects of volatility in financial markets. Furthermore, sufficient attention should be given to the economic impacts of the successive natural disasters. In assessing price developments, it was important to comprehensively examine a wide range of price indicators, including the GDP deflator.

(3) The government would do its utmost to proceed with the provision of support for the daily lives of those impacted by the natural disasters and the restoration and reconstruction of the affected areas. Moreover, the government would swiftly and steadily implement specific measures instructed in the Basic Policy on Economic and Fiscal Management and Reform 2018 and in the Growth Strategy 2018, so as to give highest priority to working on "Human Resources Development Revolution" and "Supply System Innovation," in order to raise the potential growth rate and lead Japan's economy onto a new growth trajectory.

(4) The government expected the Bank to steadily pursue monetary easing toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions.

VI. Votes

A. Vote on the Guideline for Market Operations

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

The Policy Board decided the proposal by a majority vote.

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

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

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

2. The Bank will purchase JGBs so that 10-year JGB yields will remain at around zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

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

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

B. Vote on the Guideline for Asset Purchases

To reflect the view of the members, the chairman formulated the following proposal to implement the guideline for asset purchases for the intermeeting period and put it to a vote: (1) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions, and (2) to maintain the amounts outstanding of CP and corporate bonds at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

The Policy Board decided the proposal by a unanimous vote.

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

VII. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy. Mr. Y. Harada expressed the opinion that it was appropriate to introduce forward guidance that further clarified its relationship with the price stability target. Mr. G. Kataoka expressed the following opinions: (1) the possibility of the year-on-year rate of change in the CPI increasing toward 2 percent going forward was low at this point, and (2) with a view to achieving the price stability target of 2 percent at the earliest possible time, it was appropriate for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations, rather than to make the commitment to maintaining the levels of short- and long-term interest rates.

Based on this discussion, the chairman formulated the Statement 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).

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of July 30 and 31, 2018 for release on September 25.

Attachment

September 19, 2018

Bank of Japan

Statement on Monetary Policy

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

   (1) Yield curve control

   The Bank decided, by a 7-2 majority vote, to set the following guideline for market operations for the intermeeting period. [Note 1]

   The short-term policy interest rate:

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

   The long-term interest rate:

   The Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain at around zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices.[7] With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

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

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

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

2. Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Overseas economies have continued to grow firmly on the whole. In this situation, exports have been on an increasing trend. On the domestic demand side, business fixed investment has continued on an increasing trend with corporate profits and business sentiment maintaining their improving trend. Private consumption has been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. Meanwhile, housing investment has been more or less flat. Public investment also has been more or less flat, remaining at a relatively high level. Reflecting these increases in demand both at home and abroad, industrial production has been on an increasing trend, and labor market conditions have continued to tighten steadily. Financial conditions are highly accommodative. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) is in the range of 0.5-1.0 percent. Inflation expectations have been more or less unchanged.

3. With regard to the outlook, Japan's economy is likely to continue its moderate expansion. Domestic demand is likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. Exports are expected to continue their moderate increasing trend on the back of the firm growth in overseas economies. The year-on-year rate of change in the CPI is likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising. [Note 2]

4. Risks to the outlook include the following: the U.S. macroeconomic policies and their impact on global financial markets; the consequences of protectionist moves and their effects; developments in emerging and commodity-exporting economies including the effects of the two aforementioned factors; negotiations on the United Kingdom's exit from the European Union (EU) and their effects; and geopolitical risks.

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

food) exceeds 2 percent and stays above the target in a stable manner. As for policy rates, the Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019. [Note 3] It will examine the risks considered most relevant to the conduct of monetary policy and make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target.

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

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

[Note 3] Mr. Y. Harada dissented, considering that it was appropriate to introduce forward guidance that would further clarify its relationship with the price stability target. With a view to achieving the price stability target of 2 percent at the earliest possible time, Mr. G. Kataoka dissented, considering that it was appropriate for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations, rather than to make the commitment to maintaining the levels of short- and long-term interest rates.