Not to be released until 8:50 a.m. Japan Standard Time on Tuesday, November 26, 2013.

November 26, 2013

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 31, 2013

(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 Thursday, October 31, 2013, from 9:00 a.m. to 1:09 p.m.[1]

Policy Board Members Present

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

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

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

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Mr. T. Sato

Mr. T. Kiuchi

Government Representatives Present

Mr. Y. Furukawa, Senior Vice Minister of Finance, Ministry of Finance

Mr. H. Ishii, Director-General, Economic and Fiscal Management, Cabinet Office

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director (Assistant Governor)

Mr. S. Uchida, Director-General, Monetary Affairs Department

Mr. M. Nomura, Deputy Director-General, Monetary Affairs Department[2]

Mr. K. Masaki, Head of Policy Planning Division, Monetary Affairs Department

Mr. H. Yamaoka, Director-General, Financial Markets Department

Mr. E. Maeda, Director-General, Research and Statistics Department

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on November 20 and 21, 2013 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] Mr. M. Nomura was present from 9:00 a.m. to 9:11 a.m.

Mr. S. Kameda, Head of Economic Research Division, Research and Statistics Department

Mr. H. Toyama, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. N. Yoshioka, Director-General, Secretariat of the Policy Board

Mr. N. Fukunaga, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. H. Kamiguchi, Head of Policy Infrastructure Division, Monetary Affairs Department[3]

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

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

[3] Mr. H. Kamiguchi was present from 9:00 a.m. to 9:11 a.m.

I. Review of the Effective Periods of the Temporary Bilateral Liquidity Swap Arrangements with Five Central Banks and of the Funds-Supplying Operation in Non-Domestic Currencies

A. Staff Reports

The Bank of Japan's existing temporary bilateral liquidity swap arrangements with five other central banks -- the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, and the Swiss National Bank -- were effective through February 1, 2014. These swap arrangements had helped to ease strains in financial markets and mitigate their effects on economic conditions. Taking this into account, it would be appropriate for the Bank of Japan, together with the other central banks, to convert these swap arrangements to standing arrangements, to reduce uncertainty regarding possible future extensions of the effective period. The staff therefore proposed making an amendment to the relevant principal terms and conditions, including those for the U.S. dollar funds-supplying operation against pooled collateral.

B. Vote

"Amendment to 'Principal Terms and Conditions for U.S. Dollar Funds-Supplying Operations against Pooled Collateral,'" which represented the aforementioned introduction of the standing liquidity swap arrangements, was put to a vote. Members voted unanimously to approve the amendment. It was confirmed that the amendment would be released at the same time as those by the other central banks, and that the staff would make it public accordingly.

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on October 3 and 4, 2013, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, the amount outstanding of the monetary base had been in the range of 182-191 trillion yen.

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

[5] The guideline was as follows:

The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been at low levels. The uncollateralized overnight call rate had been at a level below 0.1 percent. General collateral (GC) repo rates had recently strengthened somewhat, and had been around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been below the 0.1 percent level for all maturities, although they had strengthened somewhat. Rates on longer-term interbank instruments had declined, albeit marginally.

Long-term interest rates in Japan had been more or less flat, although they had temporarily declined somewhat partly due to the decline in U.S. long-term interest rates. The Nikkei 225 Stock Average had been more or less flat throughout the intermeeting period, despite fluctuations that mainly reflected movements in U.S. stock prices in response to developments in the fiscal debate in the United States and to a delay in the timing at which markets had expected the Federal Reserve to begin reducing the pace of its asset purchases. Prices for Japan real estate investment trusts (J-REITs) had risen slightly, mainly reflecting an increase in prices for overseas REITs. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, despite a widening in some corporate bond spreads. In the foreign exchange market, the U.S. dollar/yen rate had been more or less unchanged throughout the intermeeting period: the yen had temporarily depreciated somewhat against the U.S. dollar in the first half of October, but had appreciated somewhat thereafter.

C. Overseas Economic and Financial Developments

Overseas economies as a whole were gradually heading toward a pick-up, although a lackluster performance was partly seen.

The U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, despite downward pressure from the fiscal side. Federal government expenditures had still been declining. On the other hand, private consumption remained on a moderate increasing trend as the employment situation followed an improving trend and asset prices rose. Housing investment continued to generally pick up. Exports were also increasing moderately. Reflecting these developments in demand, business sentiment continued to follow an improving trend, and production as well as business fixed investment were heading toward a pick-up, although the pace remained slow. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less food and energy, or the core CPI, had been more or less flat. In this situation, the year-on-year rate of increase in the CPI for all items had declined, mainly as a result of the drop in energy prices.

Economic activity in Europe as a whole had bottomed out. While business fixed investment remained on a declining trend, exports had bottomed out. Private consumption had stopped decreasing, with a continued improvement in consumer sentiment, although the employment and income situation remained severe. Reflecting these developments in demand, production had bottomed out. As for prices, while slack in supply and demand conditions had been exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items excluding energy and unprocessed food followed a moderate declining trend. Annual HICP inflation for all items had declined further, mainly due to the advance in the year-on-year rate of decline in energy prices. Meanwhile, economic activity in the United Kingdom was recovering, particularly in domestic demand.

With regard to Asia, the Chinese economy continued to see stable growth on the back of firm domestic demand. Exports had been showing signs of a pick-up but remained relatively weak. On the other hand, stable growth in private consumption continued against the background of a favorable employment and income situation, although effects of the government's frugality campaign continued to be observed in some areas. Fixed asset investment had been firm amid the continued high growth in infrastructure investment. With these developments in demand, growth in production had risen somewhat, particularly that in materials industries. As for prices, the year-on-year rate of increase in the CPI had been somewhat low as a trend. Regarding the NIEs and the ASEAN countries, developments toward a pick-up had been weakening on the whole, due to deceleration in domestic demand as well as sluggish trade. Private consumption had been decelerating, particularly in the ASEAN countries, against the background of (1) the end to the boost from policy measures targeted at car sales and (2) consumer sentiment having turned cautious. Exports continued to show some weakness on the whole, although signs of a pick-up had been observed in the NIEs. Reflecting these developments in demand, moves toward a pick-up in production remained paused, and growth in business fixed investment, particularly in machinery investment, had been sluggish. As for prices, the year-on-year rates of increase in the CPI generally continued to be at somewhat low levels, although there were differences by country and region. In India, the economy remained in a state of deceleration, particularly in domestic demand.

Global financial markets had been nervous against the background of the difficulties surrounding the fiscal debate in the United States, but investors resumed their risk-taking stance after a tentative agreement was reached following the debate. In the U.S. money market, interest rates on financial instruments maturing between mid-October and mid-November, including yields on T-Bills and government bonds as well as GC repo rates, rose markedly toward October 17, a major turning point of the debt ceiling problem. Following the tentative agreement, however, these interest rates returned to the levels seen prior to the rises, and investors resumed their risk-taking stance against the background that the timing at which markets had anticipated that the Federal Reserve would begin reducing the pace of its asset purchases had been delayed. In the U.S. and European markets, stock prices had risen and long-term government bond yields had declined. Emerging markets had been nervous while the outcome of the U.S. fiscal debate remained unclear, but saw an appreciation in foreign exchange rates coupled with rises in stock and bond prices once the tentative agreement was in sight. International commodity prices had recently been more or less flat on the whole, although they continued to be weak from a relatively longer-term perspective in a situation where recovery in emerging economies lacked momentum.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports continued to generally pick up. Real exports had turned upward in the January-March quarter of 2013 on a quarter-on-quarter basis for the first time in three quarters and had grown at an accelerated rate in the April-June quarter. They then declined only marginally in the July-September quarter.

Public investment continued to increase in a situation where effects of the government's economic measures, including emergency economic measures, had come to fully take hold. The amount of public construction completed -- which reflected the progress of public works -- kept increasing in the July-August period relative to the April-June quarter, after having risen for six consecutive quarters until that quarter. The value of public works contracted -- a measure that reflected public orders -- remained at a high level in the July-September quarter, following the upsurge in the April-June quarter on a quarter-on-quarter basis.

With regard to business fixed investment, a pick-up was being observed in the manufacturing sector -- which had been relatively weak -- as corporate profits and business sentiment had improved. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- had turned upward in the April-June quarter for the first time in five quarters, after having been almost flat in the January-March quarter on a quarter-on-quarter basis, and registered a marked increase in the July-August period relative to the April-June quarter. According to the results of the survey on business fixed investment of small firms, the proportion of firms that had carried out such investment in the July-September quarter continued to rise on the whole, and business fixed investment plans for fiscal 2013 were expected to increase, as was the case in fiscal 2012.

As for the employment and income situation, supply and demand conditions in the labor market continued to improve moderately and employee income had also shown a pick-up.

Private consumption remained resilient, with some improvement observed in the employment and income situation. On a month-on-month basis, sales at department stores had increased for two consecutive months, in August and September, after having fallen back in July; they remained firm as a trend, notably in imports and high-end products. Sales at convenience stores continued to trend moderately upward. As for services consumption, outlays for travel and sales in the food service industry as a whole had held steady. Meanwhile, signs of improvement in consumer sentiment had appeared again.

As for housing investment, sales of condominiums had increased further partly due to the front-loaded increase in demand prior to the scheduled consumption tax hikes.

Reflecting these developments in demand both at home and abroad, industrial production was increasing moderately. It had turned upward -- albeit marginally -- in the January-March quarter of 2013 on a quarter-on-quarter basis for the first time in four quarters, and had increased moderately in the April-June and July-September quarters on the same basis.

As for prices, domestic corporate goods prices were rising moderately relative to three months earlier against the backdrop of movements in international commodity prices and foreign exchange rates. 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. Meanwhile, inflation expectations appeared to be rising on the whole, considering the results of surveys conducted on households, economists, and market participants.

2. Financial environment

Financial conditions were accommodative.

The monetary base had increased significantly as asset purchases by the Bank had progressed, and the year-on-year rate of growth had been at around 45 percent.

Firms' funding costs had been hovering at low levels. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. Firms' credit demand had been increasing moderately, mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been in the range of 2.0-2.5 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds was slightly negative. Firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of growth in the money stock had been in the range of 3.5-4.0 percent, mainly due to the increase in bank lending.

III. Summary of Discussions by the Policy Board on Economic and Financial Developments and the October 2013 *Outlook for Economic Activity and Prices*

A. Economic Developments

Members shared the recognition that global financial markets had been nervous for some time against the background of the difficulties surrounding the fiscal debate in the United States; subsequently, however, investors resumed their risk-taking stance in response to the tentative agreement and to the delay in the timing at which markets had expected the Federal Reserve to begin reducing the pace of its asset purchases. Meanwhile, one member noted that uncertainty surrounding future developments had actually heightened, mainly because the timing had become unclear and because resolution of the fiscal problem in the United States had been postponed to at least the beginning of 2014.

Members concurred that overseas economies as a whole were gradually heading toward a pick-up, although a lackluster performance was partly seen. As for the outlook, they shared the recognition that overseas economies -- particularly advanced economies -- would pick up gradually on the assumption that financial markets would remain generally stable. One member pointed out that, although the forecast for global growth presented in the *World Economic Outlook* released in October 2013 by the International Monetary Fund (IMF) was revised downward from that made in July, the forecast for growth in advanced economies had been almost unchanged, and therefore the scenario -- namely, that the growth rate of the global economy as a whole would gradually pick up -- had been maintained.

Members agreed that the U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, despite downward pressure from the fiscal side. As for the outlook, they shared the view that the pace of economic recovery would gradually rise, mainly as accommodative financial conditions would be maintained and the fiscal drag would gradually fade. Nevertheless, many members pointed out that resolution of the debt ceiling problem had merely been postponed and that, with uncertainty remaining, it was necessary to pay attention to (1) a halt to recovery in the housing market and (2) deterioration in sentiment and the effect of that on the economy. Meanwhile, one member expressed the view that there was a possibility that households' expectations for improvement in their income situation looked unlikely to rise, as the trend in the growth rate of labor productivity had declined.

Members shared the recognition that economic activity in the euro area as a whole had bottomed out. Some members pointed out that the economy was heading toward a pick-up but that it still lacked momentum. As for the outlook, members concurred that, while adjustment pressure associated with the European debt problem would remain, the economy would gradually pick up, supported mainly by an improvement in economic entities' sentiment. A few members noted that attention needed to be paid to the effects of the recent appreciation of the euro on exports. One of these members added that attention should also be paid to its effects on business fixed investment, given that the recent appreciation was partly attributable to the elevated real interest rates stemming from the disinflationary trend in the euro area. One member noted that it was necessary to continue monitoring whether efforts, including those toward the establishment of a banking union, would become full-fledged and thereby create a break in the adverse feedback loop among the fiscal situation, the financial system, and economic activity.

Members agreed that the Chinese economy continued to see stable growth on the back of firm domestic demand. One member pointed out that, although weakness remained in exports, the economy had picked up somewhat, mainly reflecting the stimulus measures by the government and an increase in real estate investment. As for the outlook, most members concurred that the economy would maintain stable growth at around the current pace as authorities carried out policy measures to underpin economic activity while progressing with structural reforms. One member, on the other hand, pointed out that the growth rate was likely to decline again in 2014, due to corrections to accommodative financial conditions and weaker growth in exports.

Regarding the NIEs and the ASEAN countries, members concurred that developments toward a pick-up had been weakening on the whole, due to deceleration in domestic demand as well as sluggish trade. A few members pointed out that exports remained somewhat weak, despite the fact that financial markets had calmed down, and in some economies an improvement was observed in the Purchasing Managers' Index (PMI) for new export orders. As for the outlook, members shared the recognition that the pace of economic growth in the NIEs and the ASEAN countries would likely remain relatively slow for the time being, but thereafter would gradually rise as advanced economies picked up.

Members concurred that <u>financial conditions in Japan</u> were accommodative. They shared the view that the monetary base had increased significantly, reflecting the progress in asset purchases by the Bank, and that firms' funding costs had been hovering at low levels. Members shared the recognition that firms continued to see financial institutions' lending attitudes as being on an improving trend, issuing conditions for CP continued to be favorable, and those for corporate bonds also remained favorable on the whole. As for firms' credit demand, they concurred that the amount outstanding of bank lending had been increasing moderately.

Based on the above deliberations on economic and financial conditions abroad, as well as Japan's financial conditions, members discussed <u>the state of Japan's economy</u>.

With regard to economic activity, members concurred that the economy had been recovering moderately, led by firm domestic demand, notably private consumption, while exports had been picking up at a somewhat slower pace. A few members, however, pointed out that the annualized quarter-on-quarter real GDP growth rate for the July-September quarter was likely to see a temporary but significant deceleration compared with the first half of 2013 -- when it had been around 4 percent -- mainly because private consumption would level off due to the waning of wealth effects and the reversal of the high growth registered during the first half of the year.

Members shared the recognition that, as overseas economies as a whole were gradually heading toward a pick-up, Japan's exports had generally been picking up, albeit at a somewhat slower pace, underpinned partly by developments in foreign exchange rates. Some members pointed to the weakness in exports, particularly to emerging and commodity-exporting economies. Nevertheless, regarding the outlook, members shared the view that exports would trend moderately upward, underpinned by the significant decline in the level of the yen's real effective exchange rate with a time lag and supported by the pick-up trend in overseas economies. They concurred that public investment was increasing. Members agreed that business fixed investment had been picking up as corporate profits had improved. One member said that the pick-up in such investment mainly reflected improvements in business sentiment and corporate profits, as well as a decline in real interest rates. A different member pointed out that machinery orders had begun to pick up, even in the manufacturing sector. As for the outlook, this member continued that firms' fixed investment plans were at relatively high levels in the September 2013 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), as well as in the survey results released by the Development Bank of Japan, and that fixed investment plans of small manufacturing firms had also been increasing, as confirmed in the results of a survey conducted by the Japan Finance Corporation. On the other hand, one member said that, while business fixed investment had recently been picking up, attention should be paid to whether this pace of improvement would decelerate, as the improvement in exports lacked momentum. Members shared the recognition that private consumption remained resilient, reflecting an improving trend in consumer sentiment from a somewhat long-term perspective as well as improvement seen in the employment and income situation. As for the employment and income situation, a few members pointed out that the active job openings-to-applicants ratio was improving and that nominal wages per full-time employee (regular employees excluding part-time employees) as well as hourly wages per part-time employee had generally been above the previous year's level. As for the outlook, one of these members expressed the view that a virtuous cycle would develop, whereby an increase in income through a narrowing of the negative output gap and an improvement in supply and demand conditions in the labor market would encourage a rise in spending, thereby leading to further improvement in the supply and demand conditions in the labor market. Members concurred that housing investment had increased. They shared the view that industrial production was increasing moderately, reflecting these developments in demand both at home and abroad.

Regarding 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. Many members -- noting that the year-on-year rate of change in the CPI for all items less food and energy had reached 0 percent and that marked improvement had been observed in the proportion of items for which prices had increased relative to that for which prices had decreased -- expressed the recognition that the recent inflation was attributable not only to upward pressure from movements in energy-related goods but also to price rises observed across a wide range of items. One of these members added that there was upward pressure on prices of a wide range of items on the back of resilient private consumption. In response, one member pointed out that the rate of change in the CPI for all items less food and energy relative to three months earlier had already peaked as the effects of the rapid depreciation of the yen had dissipated, and that the year-on-year rate of increase in the CPI would therefore rise at a reduced pace for some time. A different member pointed to the possibility that the effects of the rise in prices stemming from the depreciation of the yen and the rise in energy prices would disappear gradually in the immediate future. As for inflation expectations, members shared the recognition that, considering the results of surveys conducted on households, economists, and market participants, these appeared to be rising on the whole.

B. Outlook for Economic Activity and Prices

With regard to the baseline scenario of the outlook for Japan's economic activity, members shared the following view: (1) while domestic demand was likely to maintain firmness as external demand was likely to increase, albeit moderately, a virtuous cycle among production, income, and spending was likely to be maintained; and (2) therefore, while the economy would be affected by the front-loaded increase and subsequent decline in demand prior to and after the two scheduled consumption tax hikes, it was likely to continue growing at a pace above its potential, as a trend. On this basis, they agreed that, comparing the current projection with that in the July 2013 interim assessment, the growth rates were likely to be more or less unchanged.

Regarding developments in economic activity in the second half of fiscal 2013, members shared the view that, on the back of exports and industrial production -- which were likely to increase, albeit moderately -- a pick-up in business fixed investment would become further pronounced and private consumption was also likely to remain resilient, underpinned by an improvement in the employment and income situation. In addition, as a front-loaded increase in demand prior to the consumption tax hike would take place for private consumption and housing investment, they agreed that the economic growth rate for the second half of fiscal 2013 would be significantly elevated. Members shared the view that the growth rate for fiscal 2014 would slow substantially compared with the previous fiscal year, as there would be a decline in demand from the front-loaded increase in demand prior to the consumption tax hike, mainly in the first half. They continued that, nevertheless, the growth in exports was likely to accelerate, and business fixed investment would likely continue to increase firmly, partly due to monetary easing and the effects of various tax reduction measures for businesses, and owing to these developments, the economy would likely continue growing at a pace above its potential. Also, for fiscal 2015, members shared the recognition that, while affected by fluctuations in demand stemming from the scheduled second consumption tax hike, a virtuous cycle among production, income, and spending would be maintained and the economy was likely to continue growing at a pace above its potential. A few members expressed the view that the economic growth rate would generally remain unchanged or be somewhat higher than expected on the back of upward pressure on domestic demand, including the effects of the government's economic policy package, although factors including the weaker outlook for overseas economies would become downside factors to the outlook for Japan's economy. Meanwhile, one member expressed the view that, if the difference in monetary policy stance between Japan and the United States were clearly acknowledged as the Federal Reserve started to reduce the pace of its asset purchases, the virtuous cycle in economic activity was likely to strengthen further through a rise in inflation expectations and a decline in real interest rates following depreciation of the yen and a rise in Japanese stock prices.

In terms of the outlook for prices, excluding the direct effects of the consumption tax hikes, most members expressed the view that the year-on-year rate of change in the CPI was likely to follow a rising trend, reflecting factors such as the improvement in the aggregate supply and demand balance as well as the rise in medium- to long-term inflation expectations, and it was likely to reach around 2 percent -- the price stability target -- toward the latter half of the projection period. One member noted that, in order for prices to rise in line with the Bank's projection, it was extremely important that wages -- especially permanent scheduled cash earnings -- increase, because this would not only further underpin private consumption but also heighten medium- to long-term inflation expectations. As for price developments prior to and after the consumption tax hike, one member pointed out that the diffusion index for small firms' output prices released in the *Tankan* remained in negative territory, and said that it was necessary to carefully monitor whether the rise in the consumption taxes would be smoothly passed on to output prices by small firms. Most members shared the view that medium- to long-term inflation expectations were likely to continue on a rising trend under quantitative and qualitative monetary easing, partly supported by a rise in the observed inflation rate, gradually converging to around 2 percent -- the price stability target. One member, noting that the money stock had been increasing steadily, expressed the view that this would further push up the observed inflation rates with a time lag, which would in turn lead to an increase in the expected rate of inflation. In contrast, one member pointed out that it was highly uncertain whether the expected rate of inflation would rise toward the 2 percent target, and noted that, if the observed inflation rate turned out to be lower than the Bank's projection, there was a significant concern that this could undermine the credibility of the Bank's outlook and of its monetary policy. Furthermore, a different member expressed the view that, taking account of developments in inflation expectations to date, it was rather unlikely that the expected rate of inflation would rise and converge toward the price stability target of 2 percent.

Members also discussed upside and downside risk factors to the baseline scenario.

Regarding the outlook for economic activity, members noted the following upside and downside risk factors: (1) uncertainty regarding developments in overseas economies;

(2) developments in households' employment and income situation; (3) the effects of the consumption tax hikes; (4) firms' and households' medium- to long-term growth expectations; and (5) fiscal sustainability in the medium to long term.

With regard to developments in overseas economies, members concurred that the pace of recovery in the U.S. economy might become faster or slower depending on developments such as the consequences of the fiscal problem and the effects of new energy sources. As for the European economy, they agreed that attention should continue to be paid mainly to future developments in the debt problem. Regarding the Chinese economy, members shared the recognition that uncertainty was high with respect to effects of the structural problems of excess production capacity and excess debt. They shared the view that other emerging and commodity-exporting economies, some of which were facing structural problems such as current account deficits, warranted attention together with developments in the global financial markets. One member pointed out that, if financial authorities in advanced and emerging economies implemented excessive monetary easing measures without recognizing the growing structural mismatch in the labor market and in production facilities, this might lead to higher inflation and financial imbalances. One member noted the risk that exports would become weaker than expected, given the possibility that Japan's export structure had been changing due to progress in overseas production by Japanese firms.

As for developments in households' employment and income situation, members shared the recognition that, for domestic demand to continue to maintain its firmness in the future, it was important to maintain a virtuous cycle whereby improvement in the employment and income situation supported consumption. Some members said that positive efforts toward increasing base pay had started to be observed in both labor and management, and expressed the intent to pay close attention to whether these efforts prevailed. One of these members added that developments in wage increases in spring 2014 would be extremely important in terms of (1) maintaining the virtuous cycle in the economy, by mitigating the adverse effects on households' real disposable income stemming from the consumption tax hikes; and (2) raising inflation expectations. A different member pointed to the possibility that the efforts toward increasing base pay would not spread sufficiently, in which case wages and prices might be weaker than expected. Another member noted the possibility that downward pressure on scheduled cash earnings would remain, reflecting the rising trend in the ratio of part-time workers. In response, a different member pointed out that it was important that labor productivity continue to exhibit firm growth, thereby improving people's outlook for income from a relatively long-term perspective. This member continued that there was also a possibility that developments in the employment and income situation would become more positive than expected, considering trends thus far in labor supply and demand conditions, as well as in labor productivity.

Regarding the effects of the consumption tax hikes, members concurred that, although the hikes would have adverse effects on households' real disposable income, forces to mitigate adverse effects on consumption to some extent could be at work, partly because (1) various economic measures were scheduled to be taken by the government, (2) the tax hikes seemed to have already been factored in substantially among households, and (3) the rate hikes were likely to have the effect of alleviating households' future concerns over the fiscal condition and the social security system. One member expressed the view that continued improvement in the employment situation would contain downside risks stemming from the consumption tax hikes.

Members highlighted the following three points as upside and downside risk factors specific to the outlook for prices: (1) developments in firms' and households' medium- to long-term inflation expectations; (2) the responsiveness of prices to the aggregate supply and demand balance; and (3) developments in import prices.

With regard to medium- to long-term inflation expectations, many members expressed the view that, while people's inflation expectations might not readily rise in reflection of the moderate decline in prices and wages observed in the past, it was also possible that they would rise relatively quickly with a rise in observed inflation and wages. Furthermore, members concurred that effects on these expectations of price increases for items across the board associated with the consumption tax hikes warranted attention. One member expressed the view that, with an increase in scheduled cash earnings, medium- to long-term inflation expectations would become more likely to rise since there would be a growing tendency among people to take action based on the expectation that prices and wages would increase. A different member was paying attention to the extent to which the formation of inflation expectations was more forward looking, mainly through a widening acknowledgment of the prospects for a sustainable improvement in economic activity, as well as a rise in inflation expectations supported by the rise in the observed inflation rate. Meanwhile, one member pointed out that the pace at which medium- to long-term inflation expectations had recently risen was only moderate or more or less flat, and thus there were considerable downside risks.

On the responsiveness of prices to the aggregate supply and demand balance, members shared the view that attention needed to be paid to whether firms would raise prices and wages in accordance with the extent to which the supply and demand balances in goods and services as well as in employment tightened under a highly competitive environment sustained over time.

In relation to developments in import prices, members shared the recognition that there continued to be high uncertainty regarding the extent to which fluctuations in international commodity prices and foreign exchange rates were passed on to domestic prices through import prices.

Based on the above discussions, some members said that they saw risks to economic activity and prices as tilted to the downside on the whole. Many members, however, expressed the view that, as indicated in the Forecast Distribution Charts of Policy Board members, upside and downside risks recognized by the members as a whole could be assessed as being balanced. These members continued that the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) should provide an assessment by the members as a whole.

In light of the discussion on upside and downside risk factors to the outlook for Japan's economic activity and prices, members shared the recognition that there was high uncertainty regarding developments in overseas economies and medium- to long-term inflation expectations in particular, and that attention should continue to be paid to the effects of these developments on Japan's economic activity and prices.

Based on the above considerations, members assessed the economic and price situation from two perspectives.

Members made an assessment in terms of <u>the first perspective</u>: an examination of the baseline scenario of the outlook for economic activity and prices through fiscal 2015. Most members expressed the view that Japan's economy was likely to achieve around 2 percent inflation and return to a sustainable growth path toward the latter half of the projection period. Counter to this view, a few members said that it seemed difficult to achieve around 2 percent inflation toward the latter half of the projection period.

Members then made an assessment in terms of the second perspective: an examination of the risks considered most relevant to the conduct of monetary policy. With regard to the baseline scenario for economic activity, they shared the recognition that upside and downside risks could be assessed as being balanced, although uncertainty remained high, including over developments in overseas economies. Most members expressed the view that risks on the price front also could be assessed as being largely balanced, although considerable uncertainty surrounded developments in medium- to long-term inflation expectations. Members reaffirmed that there was no sign at this point of excessively bullish expectations in asset markets or in the activities of financial institutions; nevertheless, due attention needed to be paid to the fact that financial institutions' holdings of JGBs remained at an elevated level while the amount outstanding of government debt had shown a cumulative increase. Meanwhile, one member pointed out that it was necessary to thoroughly explain to the public what the assessments of the economic activity and prices from the two perspectives meant, and that the Bank should therefore describe the overall structure of the Outlook Report at the beginning of "The Bank's View."

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.

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that it was appropriate to maintain the current guideline that the Bank would conduct money market operations so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

With regard to the asset purchases, members concurred that it was appropriate for the Bank to continue with the guidelines decided when it introduced quantitative and qualitative monetary easing at the meeting on April 3 and 4, 2013. Specifically, they confirmed the following. First, the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases would be about seven years. Second, it would purchase exchange-traded funds (ETFs) and J-REITs so that their amounts outstanding would increase at an annual pace of about 1 trillion yen and about 30 billion yen, respectively. And third, for CP and corporate bonds, the Bank would continue with these asset purchases until their amounts outstanding reached 2.2 trillion yen and 3.2 trillion yen, respectively, by end-2013; thereafter, it would maintain these amounts outstanding. Some members pointed out that the Bank had been conducting its market operations more smoothly than before, partly due to the looser supply and demand conditions of T-Bills observed after entering the second half of fiscal 2013.

With respect to the future conduct of monetary policy, most members shared the view that the Bank would continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining this target in a stable manner. These members continued that, in doing so, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. In response, one member expressed concern that, in a situation where it seemed difficult to achieve the price stability target in about two years, if a rise were to occur in markets' anticipation that quantitative and qualitative monetary easing would continue for a protracted period or extreme additional measures would be implemented, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, this member said that it was appropriate to change the expression representing the Bank's commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner. A different member expressed the recognition that the price stability target was meant to be a flexible framework, and the Bank should avoid giving rise to a possible misunderstanding that its ultimate goal was to achieve the specific inflation rate of 2 percent. This member continued that the price stability target could be judged to have been achieved when it was fairly possible to envisage the inflation rate reaching 2 percent based on developments in wages, for example.

With regard to the effects of quantitative and qualitative monetary easing, members shared the recognition that these continued to firmly take hold, and financial conditions were easing steadily to underpin firms' and households' spending. They agreed that, in this situation, there was a wider range of positive movements in economic activity and financial markets, and people's expectations for economic activity and prices had turned favorable. Regarding how much of an effect could be exerted on longer-term interest rates, many members noted that long-term interest rates in Japan had been stable at low levels under the Bank's massive JGB purchases. Many members expressed the view that, in a situation where nominal interest rates had been stable, real interest rates were declining on the back of a rise in inflation expectations. Meanwhile, one member was of the opinion that, while price developments thus far had been broadly in line with the Bank's projection, the developments mainly reflected the significant contribution of the price rise in energy-related items. This member continued that, therefore, it could not yet be judged that Japan's economy was following a path toward achieving the price stability target of 2 percent as expected.

V. Remarks by Government Representatives

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

(1) About half a year had passed since the introduction of quantitative and qualitative monetary easing. The Japanese economy was on the way to recovery at a moderate pace, as seen in the fact that it had attained an annualized real GDP growth rate of more than 3 percent in two consecutive quarters, due in part to the effects of the three-pronged strategy including bold monetary easing. As for prices, there were some signs that prices had stopped decreasing across a wide range of items, indicating that deflation was ending. The government acknowledged that the Japanese economy was steadily progressing toward achieving the overcoming of deflation and economic revitalization, and understood that this was confirmed by the October 2013 Outlook Report. It expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing and achieve the price stability target of 2 percent at the earliest possible time.

(2) The government deemed it important to achieve sustainable economic growth and a desirable inflation in which employment and wages improved accordingly, amid continued progress toward overcoming deflation. To this end, with a view to aggressively implementing the Japan Revitalization Strategy and aiming to enhance the competitiveness of Japanese firms, the government had submitted the Bill for the Industrial Competitiveness Enhancement Act to the Diet. Along with this, the government would carry out special tax measures to stimulate private investment, such as the reduction of taxes on business fixed investment and on research and development.

In addition, in order to strongly encourage firms' efforts to raise wages, the government would expand the income growth promotion tax system and aim to form a common understanding toward realizing a positive cycle of the economy at the Government-Labor-Management Meeting it had launched on September 20, 2013. At a second meeting, it had also heard positive and encouraging statements from the management side.

(3) From the viewpoint of making the social security system sustainable and maintaining confidence in public finance, on October 15 the government had submitted to the Diet the so-called program bill, which presented an overall picture of the social security system reform and described how this would be implemented. The government would steadily pursue comprehensive reform of the social security and taxation systems.

(4) The government would decisively implement these measures toward achieving (1) the overcoming of deflation as well as economic revitalization and (2) fiscal consolidation through pursuit of the Medium-Term Fiscal Plan.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on the way to recovery at a moderate pace. As for the outlook, the recovery was expected to take hold as household income and business investment continued to be on upward trends while exports picked up and the effects of a range of policies developed. Prices continued to show steady progress toward overcoming deflation, as evidenced by the fact that the year-on-year rate of change in consumer prices -- all items less fresh food, petroleum products, and other specific components -- which indicated underlying trends in consumer prices, had been flat.

(2) On October 17, 2013, the government held a second meeting -- its Government-Labor-Management Meeting for Realizing a Positive Cycle of the Economy -- and reported government initiatives toward realizing a positive cycle of the economy. It also heard positive statements from the management side that they would aim to make improvement in corporate profits lead to increases in wages and employment. The government would continue to work to realize a positive cycle of the economy in an integrated manner by, for example, requesting that the related ministries and agencies encourage industries for which they were responsible to increase wages and extend support to trading partners. Furthermore, the Cabinet had

decided the Bill for the Industrial Competitiveness Enhancement Act and submitted it to the Diet, in order to accelerate and strengthen the implementation of the growth strategy. It would also submit to the Diet related bills, such as the Bill on National Strategic Special Zones, and would make efforts to promptly obtain its approval. Moreover, regarding the Trans-Pacific Partnership (TPP) Agreement, which was an important pillar for the growth strategy, the government deemed that a path toward conclusion of the negotiations and political issues had become clear through the negotiations in October, thereby creating tremendous momentum toward reaching an agreement before the end of 2013. It would continue to be proactive in achieving conclusion of the negotiations by the end of 2013. Through these initiatives, the government would work toward strengthening the growth potential of the Japanese economy.

(3) The government expected the Bank to achieve the price stability target of 2 percent, in line with the October 2013 Outlook Report discussed at this meeting. It also expected the Bank to continue providing a sufficient explanation on the state of its monetary policy conduct and its outlook for prices at the Council on Economic and Fiscal Policy and on other occasions.

VI. Votes

A. Vote on the Guideline for Money Market Operations

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

To reflect this view, the chairman formulated the following proposal and put it to a vote.

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

The guideline for money market operations for the intermeeting period ahead will be as follows, and will be made public by the attached statement (see Attachment).

> The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.

Votes against the proposal: None.

B. Decision regarding the *Outlook for Economic Activity and Prices*

Members discussed the draft of "The Bank's View" in the October 2013 *Outlook for Economic Activity and Prices* (consisting of "The Bank's View" and "The Background"), and formed a majority view.

Ms. S. Shirai, however, formulated a proposal to make the following changes. First, from the viewpoint of enhancing clarity and intelligibility, she proposed to add a paragraph at the beginning of "The Bank's View" stating, "The October 2013 Outlook Report will first present the baseline scenario of the outlook for economic activity and prices in Japan for the next one to three years. It will next highlight upside and downside risks to the baseline scenario. The Bank will then assess that scenario from two perspectives: the first perspective concerns an examination of the scenario from the viewpoint of whether the economy will follow the sustainable growth path with price stability; the second perspective involves an examination of various risks considered most relevant to the conduct of monetary policy -- including those in the longer term -- from the viewpoint of achieving the sustainable growth path with price stability. Lastly, taking into account its assessment based on those perspectives, the Bank will outline its thinking on the future conduct of monetary policy." The second change was with regard to upside and downside risks to economic activity, and Ms. Shirai proposed to add "attention should be paid to the downside risks" since there was a high degree of uncertainty regarding developments in overseas economies and households' employment and income situation. In addition, with regard to upside and downside risks to prices, she proposed to add the same description, because there was a high degree of uncertainty regarding developments in medium- to long-term inflation expectations and the responsiveness of prices to the aggregate supply and demand balance. Third, as for the future conduct of monetary policy, Ms. Shirai proposed to change the current expression that "Japan's economy has been following the path toward achieving the 2 percent price stability target as expected" to a new expression that "Japan's economy has been following the path toward achieving the 2 percent price stability target at a moderate pace." The proposal was then put to a vote, and was defeated by a majority vote.

Votes for the proposal: Ms. S. Shirai.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.

Mr. T. Sato formulated a proposal to make the following changes. First, with regard to the outlook for prices toward the latter half of the projection period, he proposed to change the current expression that the year-on-year rate of change in the CPI "is likely to reach around 2 percent" to a new expression that "around 2 percent in terms of the year-on-year rate of increase in the CPI will come into sight." Second, with regard to the baseline scenario for the outlook for economic activity and prices, he proposed changing the current expression that "Japan's economy is judged as likely to achieve around 2 percent inflation" to a new expression that "Japan's economy is judged as likely to head toward achieving around 2 percent inflation." Third, with regard to risks on the price front, Mr. Sato proposed changing the current expression that risks "can be assessed as being largely balanced" to a new expression that they "are somewhat tilted to the downside." The proposal was then put to a vote, and was defeated by a majority vote.

Votes for the proposal: Mr. T. Sato.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Kiuchi.

Mr. T. Kiuchi formulated a proposal to make the following changes. First, with regard to inflation expectations, he proposed changing the current expression that inflation expectations "are likely to continue on a rising trend under quantitative and qualitative monetary easing, partly supported by a rise in the observed inflation rate, gradually converging to around 2 percent -- the price stability target" to a new expression that they "are likely to continue on a moderate rising trend, partly supported by a rise in the observed inflation rate." Second, with regard to the outlook for prices toward the latter half of the projection period, he proposed to change the current expression that the year-on-year rate of change in the CPI "is likely to reach around 2 percent -- the price stability target" to a new expression that "the rate of increase in the CPI is expected to rise moderately." Third, with regard to the future conduct of monetary policy, Mr. Kiuchi proposed changing the current expression that "the Bank will continue with quantitative and qualitative monetary easing, 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 examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" to a new expression that "the Bank will aim to achieve the price stability target of 2 percent in the medium to long term. On this basis, it will designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years, and will review the monetary easing measures in a flexible manner when this time frame comes to an end." The proposal was then put to a vote, and was defeated by a majority vote.

Votes for the proposal: Mr. T. Kiuchi.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.

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 made public on October 31, 2013 and the whole report on November 1, 2013.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, and Mr. K. Ishida.

Votes against the proposal: Ms. S. Shirai, Mr. T. Sato, and Mr. T. Kiuchi.

Ms. S. Shirai, Mr. T. Sato, and Mr. T. Kiuchi dissented for the reasons presented in each of the aforementioned proposals.

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 3 and 4, 2013 for release on November 6, 2013.

Attachment

October 31, 2013

Bank of Japan

Statement on Monetary Policy

At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote, to set the following guideline for money market operations for the intermeeting period:

> The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.