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May 26, 2014

Bank of Japan

Minutes of the Monetary Policy Meeting

on April 30, 2014

(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 Wednesday, April 30, 2014, from 9:00 a.m. to 12:46 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. M. Asakawa, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance

Mr. S. Koizumi, Parliamentary Secretary of Cabinet Office, 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. 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

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on May 20 and 21, 2014 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.

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. T. Kawamoto, Senior Economist, Monetary Affairs Department

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

I. Summary of Staff Reports on Economic and Financial Developments[2]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on April 7 and 8, 2014, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[3] In this situation, the amount outstanding of the monetary base had been in the range of 220-226 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 risen somewhat since the start of fiscal 2014, and had recently been at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been more or less flat for all maturities. Rates on longer-term interbank instruments had been flat.

Yields on 10-year JGBs had been fluctuating narrowly, and had recently been at around 0.6 percent. The Nikkei 225 Stock Average had moved downward, mainly against the background of a decline in U.S. stock prices, but then rose somewhat, primarily due to a rebound in U.S. stock prices. It had recently been in the range of 14,000-14,500 yen. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, although some corporate bond spreads had been wide. In the foreign exchange market, the yen had appreciated somewhat against the U.S. dollar, due in part to weakening speculation among market participants that the Federal Reserve would move forward the timing of a hike in the target federal funds rate, but then recovered, primarily reflecting a rebound in U.S. stock prices. The U.S. dollar/yen rate had recently been in the range of 102-103 yen.

C. Overseas Economic and Financial Developments

Overseas economies -- mainly advanced economies -- were starting to recover, although a lackluster performance was still partly seen.

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

[3] 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.

The U.S. economy had been recovering moderately, led by private demand, with the recovery becoming more widespread. Housing investment continued to generally pick up, but the pace had been moderate. Private consumption had been firm, on the back of not only wealth effects but also the continued improvement in the employment situation. Exports also remained on an increasing trend. Reflecting these developments in demand, business sentiment and production had been improving, and business fixed investment was picking up, albeit moderately. 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, remained more or less flat. In this situation, the year-on-year rate of increase in the CPI for all items had risen, mainly because the year-on-year rate of change in energy prices had turned positive.

A pick-up in the European economy had been evident. Private consumption continued to show a moderate pick-up, with consumer sentiment continuing to improve, although the employment and income situation remained severe. There were movements toward a pick-up in business fixed investment, mainly in Germany. In addition, exports were picking up. Reflecting these developments in demand, production was picking up moderately. As for prices, slack in supply and demand conditions in the goods and labor markets was exerting downward pressure on prices, and the year-on-year rates of increase in both the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food and the HICP for all items remained on a disinflationary trend. Meanwhile, economic activity in the United Kingdom continued to recover, particularly in domestic demand.

With regard to Asia, the Chinese economy continued to see stable growth, although the economy's growth momentum was slowing somewhat. Fixed asset investment, although remaining firm, had been increasing at a somewhat reduced pace. Production had been growing at a somewhat slower pace due in part to the effects of inventory adjustments, mainly of materials and related goods. However, exports continued to pick up, particularly those to Europe and the United States. Moreover, stable growth in private consumption continued against the background of a favorable employment and income situation. Regarding the NIEs and the ASEAN countries, while economic developments in the NIEs were picking up somewhat on the back of recovery in external demand, growth momentum in the ASEAN countries remained weak, particularly in domestic demand. In India, the economy remained in a state of deceleration, particularly in domestic demand. As for prices, there were differences by country and region. Specifically, the year-on-year rate of increase in the CPI had been somewhat low as a trend in China, the NIEs, and Thailand, while that in Indonesia and India continued to be relatively high, mainly reflecting the rise in administered prices.

As for global financial markets, investors' risk-taking stance remained somewhat cautious as uncertainty about the situation in Ukraine had not been eliminated. Nonetheless, global financial markets had been calm on the whole, as seen in the fact that selling of stocks -- mainly IT stocks, as well as bio-technology and related stocks -- for position adjustments that had once been active had subsided, and that recent developments indicated resumption of investment in peripheral European countries and the assets of emerging countries. International commodity prices had been weak, but recently had risen, mainly against the background of heightened geopolitical risks reflecting the situation in Ukraine and of firm U.S. economic indicators.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had recently leveled off more or less. Developments in real exports since the start of 2014 showed large monthly fluctuations: they had decreased in January, increased markedly in February, and then decreased again in March. On a quarterly basis, they had registered a slight negative in the January-March quarter compared with the October-December quarter of 2013.

Public investment continued to increase. The amount of public construction completed appeared to be continuing to move upward, albeit with fluctuations, although it declined marginally in the January-February period compared with the October-December quarter of 2013. The value of public works contracted had decreased for two consecutive quarters after having increased significantly in the April-June quarter of 2013, but had increased again in the January-March quarter of 2014.

The pick-up in business fixed investment had become increasingly evident as corporate profits had improved. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- continued to increase as a trend, with monthly fluctuations taken into consideration. Business sentiment continued to improve on the whole, and stayed at a favorable level according to the results of surveys conducted since the start of April 2014.

As for the employment and income situation, supply and demand conditions in the labor market continued to improve steadily, and employee income had picked up moderately.

Private consumption remained resilient as a trend with improvement in the employment and income situation, albeit with some fluctuations due to the consumption tax hike. Many sales statistics for March 2014 that had been released -- for example, those for department stores and chain stores -- clearly reflected the front-loaded increase in demand, albeit with slight differences in degree based on the types of retail businesses. Interviews with firms relating to retail sales showed that many firms took the view at this point that, since the start of April, although a subsequent decline in demand following the front-loaded increase had been observed, this development was generally within the expected range and consumption had maintained its resilience as a trend.

As for housing investment-related indicators, sales of newly built condominiums in the Tokyo metropolitan area -- which, since October 2013, had continued to show a subsequent decline in demand following the front-loaded increase -- turned positive on a month-on-month basis in March 2014 for the first time in six months.

Industrial production had been on a moderate increasing trend, albeit with some fluctuations due to the consumption tax hike. Inventories had declined, affected partly by the front-loaded increase in demand, but increased in March on a month-on-month basis -- mainly in motor vehicles -- reflecting the acceleration in production to make up for the disruption in February caused by a heavy snowfall.

As for prices, domestic corporate goods prices had risen moderately relative to three months earlier, registering an increase of 0.4 percent in January and 0.3 percent in February, mainly against the backdrop of movements in international commodity prices and foreign exchange rates. They then leveled off in March relative to three months earlier, registering 0.0 percent. The year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent. Meanwhile, inflation expectations appeared to be rising on the whole.

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 55 percent.

Firms' funding costs had been hovering at low levels. With regard to credit supply, financial institutions' lending attitudes continued to be on an improving trend. Issuing conditions for CP and corporate bonds continued to be favorable. 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 at 2.0-2.5 percent. The year-on-year rate of growth in the money stock had been at around 3.5 percent, mainly due to the increase in bank lending.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments and the April 2014 *Outlook for Economic Activity and Prices*

A. Economic Developments

Members shared the recognition that global financial markets had shown some nervousness, mainly reflecting the situation in Ukraine, but had been calm on the whole. On this basis, they concurred that it was necessary to continue to closely monitor market conditions, since uncertainty had not yet been eliminated regarding geopolitical risks such as the situation in Ukraine as well as developments in currencies and stock prices of emerging economies with structural vulnerabilities.

Members concurred that overseas economies -- mainly advanced economies -- had started to recover, although a lackluster performance had still been partly seen in the emerging economies. As for the outlook, they shared the view that overseas economies were likely to moderately increase their growth rates as advanced economies continued to see firm recovery and its positive effects gradually spread to emerging economies. One member said that such an outlook was consistent with the projection for global growth presented in the *World Economic Outlook* released in April 2014 by the International Monetary Fund (IMF), in which overseas economies were expected to gradually increase their growth rates, driven by advanced economies.

With regard to developments in overseas economies by region, members agreed that, in the U.S. economy, the effects of the unusually severe winter weather were waning and the economy had been recovering moderately, led by private demand, with the recovery becoming more widespread. A few members said that, as confirmed by various recent economic indicators, the U.S. economy had emerged from the phase of being affected by the unusually severe winter weather and was returning to a recovery trend. A few members pointed out that careful attention should be paid in the future to the fact that the pace of pick-up in housing investment was moderate. On this basis, as for the outlook, members shared the view that the economy was likely to gradually accelerate its pace of recovery, as the fiscal drag would fade and an improvement in the employment and income situation would become evident. One member pointed out that many took the view that upward pressure on wages remained at a low level in the U.S. labor market, partly reflecting the presence of a large number of long-term unemployed. This member noted, however, that some took the view that it was the short-term unemployment rate that had a significant effect on wages and prices; therefore, considering that this rate had currently declined to a relatively low level, careful attention should be paid to future developments in wages and prices.

Members shared the recognition that a pick-up in the euro area economy had become evident. As for the outlook, they agreed that, while adjustment pressure associated with the European debt problem was likely to remain, the economy was likely to move from a pick-up to a moderate recovery, supported mainly by an improvement in households' and firms' sentiment.

Members agreed that the Chinese economy continued to see stable growth on the back of firm domestic demand, although the economy's growth momentum was slowing somewhat. One member said that, although the GDP figure for the January-March quarter of 2014 was higher than market expectations, it was a matter of concern that the Purchasing Managers' Index (PMI) for manufacturing activity had remained lackluster. As for the outlook, members shared the view that the economy was likely to continue to see stable growth, albeit at a slightly slower pace, mainly because (1) the Chinese authorities had taken the stance of continuing to pay consideration to economic activity while progressing with structural reforms, and had recently announced the intention to underpin economic activity by taking actions including the introduction of several specific measures; and (2) external demand was expected to continue improving moderately. One member said that due attention should be paid to the possibility that a declining trend in the economic growth rate would be prolonged until the second half of 2014 due to factors such as adjustments in the real estate market.

Regarding the NIEs and the ASEAN countries, members concurred that, while economic developments in the NIEs were picking up somewhat on the back of recovery in external demand, growth momentum in the ASEAN countries remained weak, particularly in domestic demand. As for the outlook, they shared the view that, for the time being, an adjustment phase would continue -- especially in the ASEAN countries -- and the NIEs and the ASEAN countries would likely continue to lack growth momentum. However, they continued that, thereafter, the pace of growth was likely to gradually rise due to positive effects of recovery in advanced economies, on the assumption that global financial markets remained generally stable.

Members concurred that financial conditions in Japan 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 concurred that financial institutions' lending attitudes had been on an improving trend, and issuing conditions for CP and corporate bonds continued to be favorable. They shared the recognition that, in this situation, the amount outstanding of bank lending, including that to small firms, had been increasing moderately and the year-on-year rate of growth in the money stock had been at a relatively high level.

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

With regard to economic activity, members shared the view that the economy had continued to recover moderately as a trend, albeit with some fluctuations due to the consumption tax hike. They concurred that, while exports had been somewhat weak, as domestic demand had been firm, a virtuous cycle of economic activity had been operating steadily with improvement in the employment and income situation. Regarding the effects of the consumption tax hike, many members expressed the view that the degree of the subsequent decline in demand following the front-loaded increase prior to the hike could not be gauged accurately, as hard data had not been released, but on the basis of various anecdotal information, it had been broadly in line with expectations so far. Meanwhile, one of these members pointed out that some firms in the automobile industry took the view that the subsequent decline in demand in April 2014 following the front-loaded increase was not large given the order backlogs that had accumulated until March, and it was necessary to monitor demand conditions from May onward as well.

Members shared the recognition that, in a situation where weakness remained in exports to some emerging countries including the ASEAN countries, Japan's exports had leveled off more or less, due in part to temporary factors such as the effects of the unusually severe winter weather in the United States and firms' stance of placing priority on domestic shipments in response to the front-loaded increase in demand prior to the consumption tax hike. As for the outlook, they agreed that exports were likely to increase moderately, mainly against the background of the waning of temporary downward pressure and the recovery in overseas economies. One member said that, in consideration of these developments and the past decline in the level of the yen's real effective exchange rate, exports would pick up firmly in the future. Members agreed that public investment continued to increase and was projected to continue hovering at a high level through the first half of fiscal 2014, reflecting a boost from economic stimulus, and thereafter gradually turn to a moderate downtrend. They concurred that the pick-up in business fixed investment had become increasingly evident as corporate profits had improved, and was projected to follow a moderate increasing trend. One member expressed the view that, considering factors such as the decline in real interest rates as well as the need for replacement investment -- which had been postponed so far -- and for labor-saving investment in response to wage increases, the pace of increase in business fixed investment would rise in the future. As for the employment and income situation, members shared the recognition that labor supply and demand conditions continued to improve steadily, and that employee income had also picked up moderately. Many members pointed to the fact that the wage negotiations this spring had moved in the direction of raising base pay to a certain extent. Some of these members expressed the view that upward pressure on wages was likely to strengthen further in the future given that (1) movements toward wage increases accompanying base pay increases were spreading to a wider range of firms -- including small ones -- reflecting improvement in business performance; and (2) labor supply and demand conditions were tightening in a situation where the unemployment rate was approaching a structural unemployment rate. Members shared the view that private consumption remained resilient as a trend with improvement in the employment and income situation, albeit with some fluctuations due to the consumption tax hike, and was likely to maintain its resilience. A few members expressed the view that, while a subsequent decline in demand following the front-loaded increase prior to the consumption tax hike was currently observed, private consumption would eventually regain its resilience, as an increase in employee income would steadily underpin household spending.

Regarding prices, members concurred that the year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent and the rate of increase, excluding the direct effects of the consumption tax hike, was likely to be around 1¼ percent for some time. With regard to the effects of the consumption tax hike on prices, many members expressed the recognition that the tax increase had generally been passed on to prices, considering that the year-on-year rate of increase in the CPI (all items less fresh food) -- excluding the effects of the consumption tax hike -- for the Tokyo metropolitan area was 1.0 percent for April 2014, unchanged from that for March. Some members said that movements to restrain the increase in sales prices to a level that was smaller than the increase that would be in line with the consumption tax hike -- which had been a matter of concern for some -- had not spread, as demand remained resilient. Moreover, one member expressed the view that a considerable number of firms had not yet passed on the tax increase to prices, and they would gradually do so over time as consumption bounced back. In response, one member noted that the consumption tax hike in April was a great opportunity for making revisions to sales prices, and therefore movements toward sales price revisions from May onward would likely be stable for a while. Members shared the recognition that inflation expectations appeared to be rising on the whole, considering market indicators, the results of various surveys, and other information. One member pointed to the fact that the results of surveys conducted on economists -- released in April 2014 -- indicated that medium- to long-term inflation expectations were rising steadily.

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) as domestic demand was likely to maintain firmness and exports were likely to increase, albeit moderately, a virtuous cycle among production, income, and spending was likely to be maintained; and (2) therefore, the economy was likely to continue growing at a pace above its potential as a trend, while it would be affected by the front-loaded increase and subsequent decline in demand prior to and after the two rounds of consumption tax hikes. On this basis, they agreed that, comparing the current projection for growth rates up through fiscal 2015 with that in the January 2014 interim assessment, while the growth rate for fiscal 2014 was somewhat lower, due mainly to a delay in export recovery, that for fiscal 2015 was more or less unchanged.

Regarding developments in economic activity in fiscal 2014, members shared the view that the growth rate for the April-June quarter was likely to temporarily decline due to effects of the subsequent decline in demand following the front-loaded increase prior to the consumption tax hike. They continued, however, that private consumption was likely to maintain its resilience as a trend, underpinned by an improvement in the employment and income situation, and therefore the effects of the subsequent decline in demand following the front-loaded increase prior to the consumption tax hike would likely dissipate from summer. A few members said that many firms seemed to consider that the effects of the subsequent decline in demand following the front-loaded increase prior to the consumption tax hike were not likely to last for such a long period. Members concurred that the economy was likely to return to a growth path that was above its potential from summer, as (1) exports were likely to start increasing, albeit moderately; and (2) business fixed investment was also likely to follow a moderate uptrend due mainly to an improvement in corporate profits, a rise in the capacity utilization rate, and effects of monetary easing. As for fiscal 2015 through fiscal 2016, they shared the view that a virtuous cycle of economic activity would be maintained -- supported by (1) a firm increase in domestic private demand reflecting accommodative financial conditions and heightened growth expectations, as well as (2) an increase in exports due to an improvement in overseas economies -- and that the economy was likely to continue growing at a pace above its potential, while fluctuations in demand stemming from the scheduled second consumption tax hike were anticipated.

In terms of the outlook for prices, excluding the direct effects of the consumption tax hikes, many members expressed the view that (1) the year-on-year rate of increase in the CPI was likely to be around 1¼ percent for some time, follow a rising trend again from the second half of fiscal 2014, and reach around 2 percent around the middle of the projection period; and (2) thereafter the economy was likely to gradually shift to a growth path that sustained such inflation in a stable manner. As background to this view, these members cited the following. First, the aggregate supply and demand balance (output gap, and the same hereafter) had been improving mainly on the labor front; it appeared to have reached around the past long-term average of about zero and was likely to continue improving. And second, as the observed inflation rate rose above 1 percent, medium- to long-term inflation expectations were likely to follow an increasing trend and gradually converge to around 2 percent -- the price stability target. Some members expressed the view that some firms were taking a stance of passing on past rises in costs to sales prices, and raising sales prices while increasing value-added and tapping new potential demand. These members continued that such a tendency was likely to continue. A few members pointed out that resumption of base pay increases, which had occurred as a result of the wage negotiations this spring, was an important mechanism that would affect wage negotiations in the next fiscal year and beyond. One of these members expressed the view that changes in firms' price-setting behavior and resumption of base pay increases would increase the responsiveness of inflation to the output gap, as well as people's medium- to long-term inflation expectations. Meanwhile, one member expressed the recognition that 2 percent inflation would be achieved at around the end of the projection period, since rises in inflation expectations and firms' sales prices would progress moderately. This member also noted that the description of the price outlook should focus on the timeframe when the "price stability target of 2 percent" would be achieved, rather than providing an expression -- namely, "around 2 percent" -- that contained a degree of latitude. A different member said that it was highly uncertain whether the expected rate of inflation would rise toward the 2 percent target. Another member expressed the view that (1) it was uncertain to what extent factors such as tighter labor supply and demand conditions would push up prices in a situation where the effects of the upward pressure from the depreciation of the yen would likely subside over time, and (2) it was rather unlikely that the expected rate of inflation would rise and converge toward the price stability target of 2 percent.

On this basis, members agreed that, comparing the current projections with those in the January 2014 interim assessment, while the growth rate for fiscal 2014 was somewhat lower, the projected rates of increase in prices were more or less unchanged as (1) continued firm domestic demand, which tended to have large stimulative effects on employment, had tightened labor supply and demand conditions, and this situation was likely to be reinforced, and (2) a rise in medium- to long-term inflation expectations seemed to have started to influence actual wage and price settings. Many members expressed the view that, because the current economic recovery was led mainly by nonmanufacturing, which tended to have large stimulative effects on employment, labor supply and demand conditions were inclined to tighten, and therefore prices had exhibited a greater tendency to rise due to the factors associated with the labor market. One member, however, said that wage increases and price rises resulting from supply-side constraints might not be sustainable.

Members discussed how a rise in inflation expectations affected actual wage and price settings. They shared the recognition that a rise in the inflation rate had been taken into account in the recent labor-management wage negotiations, and that a shift in firms' price-setting strategy, from a low-price strategy to one of raising sales prices while increasing value-added, had started to be seen. One member expressed the view that the perception of price developments by firms and households -- which were the main entities of actual economic activity -- had been shifting from "prices would decline" to "prices would increase moderately." This member continued that, in this situation, firms' and households' behavior was changing. With regard to firms' perception of price developments, a different member -- noting that in the March 2014 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), firms had presented an outlook for relatively high inflation levels and expected the inflation rate to rise over time -- said that this was highly meaningful, considering that firms generally tended to take a cautious view. This member continued that this perception of price developments by firms would act as an important factor in their price-setting behavior and wage negotiations in the future. A few members said that, in a situation where a change in firms' and households' perception of price developments had been observed, resumption of base pay increases during the wage negotiations this spring was significant. Regarding firms' price-setting behavior, some members pointed out that, partly because the prospects for continued sustainable improvement in economic activity were becoming widely acknowledged, some firms had started to take a stance of passing past rises in costs directly on to sales prices. On this point, a few members expressed the view that whether such behavior by firms would spread over time depended on whether firmness in domestic demand would be maintained.

Members discussed the background to the narrowing of the output gap. Some members -- pointing out that the output gap had reached close to zero at a pace faster than expected -- expressed the view that this suggested that the current economic recovery was led mainly by nonmanufacturing, which was labor intensive, and that the upper limit of supply capacity for Japan's economy had been declining from a relatively longer-term perspective due in part to a low birth rate and aging population, as well as to a postponement of business fixed investment after the Lehman crisis. On this basis, these members continued that, in order for Japan's economy to maintain its sustainable growth, it was important to raise the potential growth rate by, for example, implementing the growth strategy. One member said that, to this end, efforts were necessary to improve productivity in nonmanufacturing. A different member pointed to the need to foster an environment where it was easier for women and the elderly to participate in the workforce, which in turn would increase their labor participation. In relation to this, in terms of nonmanufacturing, one member expressed the view that productivity had been rising, considering that business fixed investment was firm and profitability was increasing, and that firms in a wide range of industries were making progress in tapping various types of potential demand.

Members also discussed <u>upside and downside risk factors</u> to the baseline scenario of the outlook for economic activity and prices.

Regarding the outlook for economic activity, members noted the following upside and downside risk factors: (1) uncertainty regarding developments in exports; (2) the effects of the consumption tax hikes; (3) firms' and households' medium- to long-term growth expectations; and (4) fiscal sustainability in the medium to long term.

As for developments in exports, members concurred that, while, basically, the recent weakness in exports had been due mainly to the sluggishness in emerging economies including ASEAN economies that had strong ties with Japan's economy, it was likely that effects of structural factors such as a spreading of the shift of Japanese manufacturers' production sites to overseas had also played a certain role. On this basis, they shared the recognition that, depending on future developments in overseas economies -- such as in emerging economies, the prospects for the European debt problem, and the pace of recovery in the U.S. economy -- as well as the situation for Japanese firms' production share at home and abroad, exports might either deviate upward or downward.

Members agreed that, although the consumption tax hikes would have adverse effects on real disposable income, forces to mitigate adverse effects on consumption to some extent could be at work, partly because (1) various economic measures were 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. In relation to this, one member expressed concern over the worsening in consumer sentiment that was seen since around the latter half of 2013. One member expressed the view that the extent to which the improvement in the employment and income situation could absorb the effects of the consumption tax hikes was important.

Members shared the recognition that, in the case of the aforementioned upside and downside risks to the economy materializing, prices would also be affected to a certain degree. As other factors that could exert upside and downside risks to prices, they highlighted the following four points: (1) developments in firms' and households' medium- to long-term inflation expectations; (2) developments in the output gap, particularly in labor supply and demand conditions; (3) the responsiveness of inflation to the output gap; and (4) developments in import prices.

With regard to firms' and households' medium- to long-term inflation expectations, most members expressed the view that, amid a rise in observed price and wage inflation, there was uncertainty about the pace at which inflation expectations would rise. Furthermore, members concurred that effects on people's expectations of price increases in a wide range of items associated with the consumption tax hikes warranted attention.

In terms of developments in labor supply and demand conditions, members shared the view that, although the baseline scenario assumed that the increase in labor participation by the elderly and women would continue to some extent going forward, there was uncertainty associated with this assumption. In addition, they agreed that, even with the same economic growth rate, the degree of labor shortage in the economy as a whole might change depending on the balance between manufacturing and nonmanufacturing, for which the extent of labor intensity differed.

As for the responsiveness of inflation to the output gap, members shared the view that attention needed to be paid to what extent firms would raise prices and wages as supply and demand conditions in goods and services as well as in employment tightened. One member was of the opinion that, considering the highly competitive environment, price rises initiated by firms were likely to be moderate. In contrast, a few members pointed out that, judging mainly from price developments to date, firms seemed to have started to change their low-price strategy, and these members expressed the view that, in this situation, the responsiveness of inflation to the output gap had been rising.

With regard to developments in import prices, members shared the view that domestic prices might either deviate upward or downward through import prices, depending on fluctuations in international commodity prices and foreign exchange rates.

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 exports 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 2016. Many members expressed the view that Japan's economy was judged as likely to achieve around 2 percent inflation around the middle of the projection period, and thereafter gradually shift to a growth path that sustained such inflation in a stable manner. In response, some members expressed a more cautious view on the outlook for prices.

Members then made an assessment in terms of <u>the second perspective</u>: 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 that regarding developments in exports. Most members expressed the view that risks on the price front also could be assessed as being largely balanced, although considerable uncertainty surrounded developments, mainly in medium- to long-term inflation expectations. Counter to this, one member viewed risks to prices as tilted to the downside.

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

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

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 Japan real estate investment trusts (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 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 conduct of monetary policy, most members shared the recognition 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. Members expressed the view that it was appropriate for the Bank to continue to steadily pursue quantitative and qualitative monetary easing in accordance with the current guidelines, as such easing had been exerting its intended effects.

On the other hand, one member said that, 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 in a situation where it was unlikely that the price stability target would be achieved in about two years, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, the 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 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.

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. Regarding how much of an effect could be exerted on longer-term interest rates, they agreed that long-term interest rates in Japan had been stable at low levels under the Bank's massive JGB purchases. Members shared the recognition that, in a situation where nominal interest rates had been stable, real interest rates had been declining on the back of a rise in inflation expectations. One member expressed the view that, considering that the effects of monetary policy on economic activity would appear with a certain time lag, the effects of quantitative and qualitative monetary easing on economic activity would further strengthen over time.

IV. Remarks by Government Representatives

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on a moderate recovery trend, while some weak movements were seen due to a reaction after a last-minute rise in demand. Regarding the situation in private consumption after the beginning of April 2014, some took the view that outlays for travel and sales in part of the food service industry continued to show a steady undertone, and the year-on-year rate of decline in sales at various retail stores had been slowing, especially in the food and beverage as well as related industries, which were clearly starting to pick up. The government deemed that such weak movements were only temporary and that there was no change in the moderate recovery trend of the economy. As for the outlook, although weakness remained for the time being due to a reaction after a last-minute rise in demand, the economy was expected to recover moderately as the effect of the subsequent decline in demand gradually lessened and the effects of various policy measures emerged.

(2) The government had been making efforts to swiftly implement the Economic Measures for Realization of Virtuous Cycles, and had released the first results of its review of the progress made with regard to the measures on April 28, 2014. About 60 percent of business that the government would conduct had reached the contract stage with firms, and it could be judged that the economic measures were being implemented smoothly on the whole. At the Council on Economic and Fiscal Policy held on April 16, the government had received reports on the situation of the wage negotiations this spring from the Japan Business Federation (Keidanren), the Japan Chamber of Commerce and Industry, and the Japanese Trade Union Confederation (Rengo). With the aim of realizing a virtuous cycle of the economy, the government hoped that movements toward wage increases would continue to take hold at a wider range of firms. It had launched the Council for Promotion of Foreign Direct Investment in Japan on April 25, and confirmed such items as the guidelines based on the Report on the Expert Group Meeting on Foreign Direct Investment in Japan. As for the Japan-Australia Economic Partnership Agreement (EPA), Japan and Australia had reached a general agreement on April 7. Meanwhile, with regard to the Trans-Pacific Partnership (TPP) Agreement, as a result of meetings and consultations including the Japan-U.S. summit meeting held on April 24, Japan and the United States had identified a path forward on important bilateral issues, and achieved substantive results, which marked a key milestone in the TPP negotiations. Both countries would exert leadership and call upon the TPP partners to reach agreement on the negotiations.

(3) The government expected the Bank to achieve the price stability target of 2 percent, in line with the April 2014 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). 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.

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

(1) The government acknowledged that the Japanese economy had been steadily progressing toward achieving the overcoming of deflation and economic revitalization, and understood that this was confirmed by the April 2014 Outlook Report. It expected

the Bank to steadily pursue quantitative and qualitative monetary easing and achieve the price stability target of 2 percent at the earliest possible time.

(2) The view was widely held that, although a reaction after a last-minute rise in demand before a consumption tax hike was seen mainly in consumption, this was in line with expectations, and the government deemed that the economic fundamentals remained firm. It would closely monitor economic developments, and with the aim of swiftly getting the economy back on a growth path, it would also focus on swiftly implementing the supplementary budget for fiscal 2013 and the initial budget for fiscal 2014.

(3) With a view to achieving sustainable economic growth led by private demand, the government had been holding discussions at the Industrial Competitiveness Council and on other occasions, in view of the revision on the growth strategy to be made in the middle of 2014. The discussions had covered issues such as (1) creating a world-class environment where workers and enterprises could fulfill their potential, including the promotion of active social participation by women; (2) turning medical and nursing care as well as agriculture into new engines for growth; and (3) ensuring that the fruits of growth -- which were to be achieved, for example, by promoting the utilization of the Public-Private Partnership (PPP) and Private Finance Initiative (PFI) -- reached such entities as local communities and small firms. Moreover, at a joint meeting of the Council on Economic and Fiscal Policy and the Industrial Competitiveness Council held on April 16, Mr. Aso, the Minister of Finance, made the following proposals with a view to providing medium- to long-term private-sector funds intended to improve firms' profitability and promote economic growth, as risk money: (1) utilization of equity, which would support activities by firms such as boldly selecting areas to allocate resources and concentrating that allocation on such areas as well as overseas business mergers and acquisitions; (2) use of mezzanine financing as a means to provide risk money that was necessary, for example, to strengthening the competitiveness of Japanese firms and redevelop urban areas; and (3) promotion of medium- to long-term private lending to maintain and improve the infrastructure.

(4) The government had also been holding active discussions on the prioritization and streamlining of expenditure, such as in social security, at the Council on Economic and Fiscal Policy and on other occasions. It would work to realize a virtuous cycle

between sustainable economic growth, led by private demand, and fiscal consolidation by doing its utmost to achieve further structural reforms and fiscal consolidation.

V. 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 April 2014 *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 change the current expression regarding the outlook for prices. The existing wording was that "the year-on-year rate of increase in the CPI is likely to reach around 2 percent -- the price stability target -- around the middle of the projection period. Thereafter, the year-on-year rate of increase in the CPI is likely to edge up as medium- to long-term inflation expectations will converge to around 2 percent and the output gap is expected to continue expanding in positive territory."

The new expression proposed by Ms. Shirai was that "the inflation rate of 2 percent is likely to be reached toward the end of the projection period as the Bank continues 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. Thereafter, Japan's economy is expected to gradually shift to a growth path that sustains such inflation in a stable manner." 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, he proposed to change the current expression that the year-on-year rate of increase in the CPI "is likely to follow a rising trend again from the second half of this fiscal year, and reach around 2 percent around the middle of the projection period" 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 around the middle of the projection period." Second, with regard to the first perspective, which concerned an examination of 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 it "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 medium- to long-term inflation expectations "are likely to follow an increasing trend and gradually converge to around 2 percent -- the price stability target" to a new expression that they "are also likely to remain stable." Second, with regard to the outlook for prices, he proposed to change the current expression that the year-on-year rate of increase in the CPI "is likely to be around 1¼ percent for some time, follow a rising trend again from the second half of this fiscal year, and reach around 2 percent around the middle of the projection period" to a new expression that it "is likely to remain generally stable around the current level over time." 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 April 30, 2014 and the whole report on May 1, 2014.

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.

VI. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of April 7 and 8, 2014 for release on May 7, 2014.

Attachment

April 30, 2014

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.