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January 26, 2015

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 18 and 19, 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 Thursday, December 18, 2014, from 2:00 p.m. to 4:28 p.m., and on Friday, December 19, from 9:00 a.m. to 12:23 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. I. Miyashita, State Minister of Finance, Ministry of Finance[2]

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

Mr. Y. Nishimura, State Minister of Cabinet Office, Cabinet Office[2]

Mr. A. Nakamura, Deputy Director-General, Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. M. Amamiya, Executive Director

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

Mr. S. Kuwabara, Executive Director

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1 The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on January 20 and 21, 2015 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

2 Messrs. I. Miyashita and Y. Nishimura were present on December 19.

3 Messrs. H. Sakota and A. Nakamura were present on December 18.

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

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

Mr. S. Nagai, 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. R. Hattori, Senior Economist, Monetary Affairs Department

Mr. R. Kato, Senior Economist, Monetary Affairs Department

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on November 18 and 19, 2014, 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 256-269 trillion yen.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments continued to be at low levels. The uncollateralized overnight call rate and general collateral (GC) repo rates had been at levels below 0.1 percent, the interest rate applied to the Bank's complementary deposit facility. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) continued to be negative but had recently marked somewhat smaller negative figures.

In the bond market, interest rates across the entire yield curve had declined further since the previous meeting. Specifically, yields in the long-term zone had followed a moderate downward trend on the back of a general decline in long-term interest rates abroad, mainly reflecting a decline in crude oil prices, and had recently been at around 0.35 percent. In this situation, yields on the shorter end had sometimes been slightly negative as the negative yields on T-Bills had gradually affected them. Yields in the medium-term zone had been below the 0.1 percent level. The Nikkei 225 Stock Average had risen at one time, mainly as a reflection of the yen's depreciation, and temporarily exceeded the 18,000 yen level. It had fallen recently to around 17,000 yen, mainly against the background of declines in overseas stock prices. In the foreign exchange market, the yen had depreciated against the U.S. dollar, mainly since the difference in the direction of monetary policy between Japan and the United States continued to be recognized. The yen then appreciated somewhat against the U.S. dollar, mainly reflecting declines in overseas stock prices. Meanwhile, the euro had generally been more or less flat against the dollar.

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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 will conduct money market operations so that the monetary base will increase at an annual pace of about 80 trillion yen.

C. Overseas Economic and Financial Developments

Overseas economies -- mainly advanced economies -- had been recovering, albeit with a lackluster performance still seen in part.

The U.S. economy continued to recover steadily, led by private demand. Private consumption had increased firmly, with employment increasing at a faster pace. Housing investment had also followed a moderate pick-up trend. Exports continued on their increasing trend. Reflecting these developments in demand, business sentiment and the momentum in production activity had been strengthening, and business fixed investment continued to recover. 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 risen marginally while that for all items had dropped slightly, mainly due to the decline in energy prices.

The recovery in the European economy had been losing momentum recently. Private consumption continued to recover moderately on the back of an improving trend in compensation of employees. However, the pace of the pick-up in exports had been sluggish and production was roughly flat. Not only had business sentiment turned cautious in manufacturing, but this development was spreading to other sectors as well, and movements toward a pick-up in business fixed investment had come to a pause. As for prices, the year-on-year rates of increase in the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food and in the HICP for all items remained low, both being clearly below the quantitative definition of price stability set by the European Central Bank (ECB), which was below, but close to, 2 percent. Meanwhile, economic activity in the United Kingdom continued to recover, led mainly by domestic demand.

With regard to emerging economies, the Chinese economy generally maintained its stable growth, due mainly to an improvement in external demand and the stimulus measures by the government, although there remained downward pressure associated with structural reforms. Exports continued to increase, particularly to the United States and Asia. Stable growth in private consumption continued against the background of a favorable employment and income situation. On the other hand, the slowing trend in the pace of growth in fixed asset investment continued on the whole, since the paces of increase in investment in real estate and manufacturing had slowed, although public investment remained firm. The pace of growth in production had been slowing moderately. Meanwhile, although the pace of pick-up in exports had been decelerating recently, the

NIEs had been improving on the whole as domestic demand continued on a pick-up trend. On the other hand, despite a continued improving trend in exports, the ASEAN economies as a whole had been lacking growth momentum since improvement in private consumption had been slow in some economies. In India, the economy had bottomed out on the back of improvement in sentiment and a decline in inflation rates. Economic activity in Russia had been stagnant, particularly in domestic demand, reflecting a tightening of financial conditions due to the raising of policy interest rates and to capital outflow.

As for prices of emerging economies, inflation rates in many economies had decreased, mainly because of the decline in energy prices. On the other hand, inflation rates had been rising in some Asian economies due to the effects of a reduction in fuel subsidies; rates had also been rising in countries such as Brazil and Russia, mainly due to the effects of the depreciation of their currencies and to the increase in food prices.

Regarding global financial markets, the U.S. dollar had appreciated, reflecting market participants' awareness of the differences in perceived business conditions and the direction of monetary policy between the United States and other countries. In this situation, currencies in emerging economies had been weak on the whole, and they had fallen substantially in oil- and commodity-exporting economies in particular, such as Russia. In international commodity markets, crude oil prices continued to decline substantially, partly due to the effects of the decision by the Organization of the Petroleum Exporting Countries (OPEC) not to reduce oil production.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had shown signs of picking up. Real exports, after turning slightly positive in the July-September quarter of 2014 on a quarter-on-quarter basis, had risen noticeably in the October-November period relative to the July-September quarter. Exports were expected to increase moderately, mainly against the background of the recovery in overseas economies.

Public investment had more or less leveled off at a high level. It was expected to continue to stay at around this level for the time being and thereafter gradually enter a declining trend.

Business fixed investment had been on a moderate increasing trend as corporate profits had improved. Meanwhile, business sentiment had generally stayed at a favorable level, although some cautiousness had been observed. In the December 2014 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), the diffusion index for business conditions for all industries and enterprises (the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable") had improved marginally from the September *Tankan* and remained in "favorable" territory to a marginal degree. However, (1) the diffusion index had shown mixed movements by industry and size, and (2) some cautiousness about the outlook had been observed. Business fixed investment was projected to continue a moderate increasing trend as corporate profits followed their improving trend. Business fixed investment plans (for all industries and enterprises, excluding software investment and including land purchasing expenses) for fiscal 2014 in the December *Tankan* had been revised upward from those in the September *Tankan*, to a year-on-year increase of 5.5 percent -- which represented relatively high growth compared with the rate of increase in investment plans for fiscal 2013 as of December 2013. This upward revision was made as current profits in firms' business plans had been forecasted to maintain their high level on a par with those for fiscal 2013, which had seen large profit increases.

As for the employment and income situation, labor market conditions continued to improve steadily, as evidenced by the moderate improving trend in the unemployment rate. Regarding wages, nominal wages per employee had been rising moderately, albeit with fluctuations, as non-scheduled cash earnings continued to increase and the pick-up in scheduled cash earnings had recently become evident. Reflecting these developments in employment and wages, the year-on-year rate of increase in employee income had been climbing moderately.

Private consumption remained resilient as a trend with the employment and income situation improving steadily, and the effects of the decline in demand following the front-loaded increase prior to the consumption tax hike had been waning on the whole. Many sales statistics had started to show a moderate increase in the July-September quarter, after a substantial fall in the April-June quarter, and had maintained their uptrend in October, excluding the negative effects stemming from the landfall of two typhoons. As for durable goods, the number of new passenger-car registrations had almost bottomed out, and sales of household electrical appliances had started picking up moderately. Services consumption, such as that related to travel, remained steady. However, looking at indicators related to consumer confidence, the consumer confidence index -- which had improved temporarily around summer 2014, after having exhibited cautiousness from around the end of 2013 through around spring 2014 -- once again was starting to indicate caution. Private consumption was expected to remain resilient with the employment and income situation continuing to improve steadily, and the effects of the decline in demand following the front-loaded increase were expected to dissipate gradually.

Housing investment, which had continued to decline following the front-loaded increase, had recently started to bottom out. The number of housing starts -- a leading indicator of housing investment -- had continued to fall since the January-March quarter, mainly in owner-occupied homes and houses, but had virtually bottomed out recently. Such investment was projected to regain its resilience gradually with the employment and income situation continuing to improve steadily, supported as well by accommodative financial conditions.

Industrial production had started to bottom out, due in part to the progress in inventory adjustments. It had fallen back noticeably from the front-loaded increase in demand in the April-June quarter on a quarter-on-quarter basis and continued to decrease in the July-September quarter, but had turned upward for October relative to the July-September quarter, by 1.8 percent. Industrial production was expected to resume its moderate increase with final demand continuing to rise and inventory adjustments progressing further.

As for prices, excluding the direct effects of the consumption tax hike, the producer price index (PPI) was declining relative to three months earlier, reflecting the significant fall in international commodity prices. The year-on-year rate of increase in the CPI (all items less fresh food) was around 1 percent. With regard to the outlook, the PPI was expected to continue declining for the time being, reflecting movements in international commodity prices, and the year-on-year rate of increase in the CPI was likely to be at around the current level for the time being.

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 35 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 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 in the range of 2.5-3.0 percent. Firms' financial positions had been favorable. 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. Inflation expectations appeared to be rising on the whole from a somewhat longer-term perspective. The break-even inflation rates had been declining, partly because crude oil prices continued to fall. Meanwhile, there was no significant change in the inflation outlook of households, firms, and economists.

3. The fund-provisioning measure to support strengthening the foundations for economic growth and the fund-provisioning measure to stimulate bank lending

On December 5, 2014, the Bank had carried out a new loan disbursement, amounting to 1,153.0 billion yen, under the main rules for the fund-provisioning measure to support strengthening the foundations for economic growth. The outstanding balance of loans disbursed by the Bank under these rules amounted to 4,319.6 billion yen after the new loan disbursement. The outstanding balance of loans disbursed by the Bank under the special rules for equity investments and asset-based lending (ABL) came to 115.6 billion yen, and that under the special rules for small-lot investments and loans amounted to 9.083 billion yen. As for the special rules for the U.S. dollar lending arrangement, the outstanding balance of loans had reached the limit of loans to be disbursed, which was 12.0 billion dollars.

On December 16, 2014, the Bank had carried out a new loan disbursement, amounting to 3,133.6 billion yen, under the fund-provisioning measure to stimulate bank lending. The outstanding balance of loans disbursed by the Bank amounted to 18,977.3 billion yen after the new loan disbursement.

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

A. Economic Developments

Members shared the recognition that global financial markets had shown some nervousness, as seen, for example, in the fact that crude oil prices continued to decline substantially and that the currencies of some emerging and commodity-exporting economies had fallen sharply. In particular, many members noted that it was necessary to closely monitor developments in Russia as a risk to global financial markets and to the global economy, notably the European economy. A few members pointed out that the currencies of some commodity-importing economies had also fallen noticeably recently amid the transition to a change in U.S. monetary policy. Some members expressed the recognition that, although the decline in crude oil prices generally had positive effects on the global economy as a whole, particularly on advanced economies, it could entail the risks of destabilizing financial markets and of exerting downward pressure on the economy, mainly through the fall in currencies of commodity-exporting economies and a deterioration in the creditworthiness of energy-related firms.

Members concurred that overseas economies -- mainly advanced economies -- had been recovering, albeit with a lackluster performance still seen in part. As for the outlook, they shared the recognition that overseas economies -- particularly advanced economies -- would continue to recover moderately.

With regard to developments in overseas economies by region, members agreed that the U.S. economy continued to recover steadily, led by private demand. They shared the view that private consumption had increased firmly on the back of improvement in the employment situation and the decline in gasoline prices, and that this had been exerting positive effects on corporate activity. One member noted that imports from emerging economies such as those in Asia had increased on the back of the continued U.S. economic recovery, exerting positive effects on other regions as well. As for the outlook, members shared the recognition that the economy was likely to continue to see a solid recovery as firmness in the household sector would continue to spread to the corporate sector. A few members added that the pace of recovery could accelerate given, for example, that improvement in the employment situation had been progressing rapidly.

Members shared the recognition that the recovery in the euro area economy had been losing momentum recently. As for the outlook, they concurred that the economy would likely maintain its recovery as a trend -- albeit at a moderate pace -- supported mainly by the resilience in private consumption and an increase in exports, although the recovery would likely be sluggish for the time being due in part to the spread of business sentiment turning cautious. Members also shared the recognition that the possibility of low inflation rates becoming entrenched and the effects of developments in Russia warranted attention. Some members added that the political turmoil in Greece might have adverse effects on the euro area economy.

Members agreed that the Chinese economy generally maintained its stable growth due mainly to an improvement in external demand and the stimulus measures by the government, although there remained downward pressure associated with structural reforms. As for the outlook, they shared the view that the economy would likely continue to see generally stable growth, albeit at a somewhat slower pace, as authorities carried out stimulus measures while progressing with structural reforms.

Regarding emerging economies, members agreed that the number of countries and regions where economic activity had been picking up had been increasing gradually, triggered by a rise in exports to advanced economies; however, some weakness remained, particularly in some ASEAN countries, Brazil, and Russia. They then concurred that emerging economies as a whole remained lackluster in terms of growth. Many members expressed the view that economic activity in Russia had been stagnant, particularly in domestic demand, reflecting the tightening of financial conditions due to the raising of policy interest rates -- a policy action taken in response to the acceleration in the depreciation of the Russian ruble against the background of the decline in crude oil prices. Members shared the recognition that emerging economies were likely to gradually increase their growth rates as positive effects of recovery in advanced economies -- particularly in the United States -- spread, and as this process triggered a pick-up in domestic demand, although differences remained across countries and regions.

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

With regard to economic activity, members concurred that, in a situation where a virtuous cycle from income to spending continued to operate steadily in both the household and corporate sectors, the economy continued to recover moderately as a trend, and effects such as those of the decline in demand following the front-loaded increase prior to the consumption tax hike had been waning on the whole. With regard to the outlook for the economy, they shared the recognition that it was likely to continue on its moderate recovery trend, and that effects such as those of the decline in demand following the front-loaded increase prior to the consumption tax hike were likely to dissipate. Some members added that the recent decline in crude oil prices would be a factor that would exert upward pressure on economic activity through rises in corporate profits and households' real income.

Members agreed that Japan's exports had shown signs of picking up and were likely to increase moderately, mainly against the background of the recovery in overseas economies. One member expressed the view that the effects of the yen's depreciation might be starting to appear, particularly in capital goods. As for future developments in exports of automobiles, a few members noted that the decline in gasoline prices might act as a headwind against Japanese automobiles that had an edge in terms of fuel efficiency.

Members shared the view that business fixed investment had been on a moderate increasing trend as corporate profits had improved, and it was projected to continue on such a trend. Many members expressed the recognition that, as shown in the December 2014 *Tankan*, business sentiment had generally stayed at a favorable level, although some cautiousness had been observed, and firms' business plans indicated that firms were planning to steadily increase fixed investment in view of improvement in the profit outlook. One member pointed out that actual investment had been proceeding at a slower pace than that suggested by the business fixed investment plans for fiscal 2014 in the *Tankan*. On this basis, the member expressed the recognition that the downward revisions made to the investment plans for the first half of the fiscal year had been somewhat large, suggesting that there might be a growing tendency by firms to postpone their plans. In response, a few members commented that, although postponement of business fixed investment reflecting the sluggish economic recovery had been observed in the first half of fiscal 2014, such investment was projected to follow an increasing trend, taking into account the pick-up in the aggregate supply of capital goods, for example. One member expressed the recognition that current profits in firms' business plans could be revised further upward, as the yen had been depreciating further from firms' projected value of it against the U.S. dollar, in comparison with the time when the December *Tankan* was conducted. Meanwhile, some members expressed the view that the results of various surveys indicated that business sentiment had turned cautious, and therefore careful attention should be paid to future developments.

As for the employment and income situation, members shared the view that, with labor market conditions continuing to improve steadily, employee income had increased moderately and was likely to continue to do so. Some members said that winter bonus payments for 2014 also seemed to have increased.

Members agreed that private consumption remained resilient as a trend with the employment and income situation improving steadily, and the effects of the decline in demand following the front-loaded increase prior to the consumption tax hike had been waning on the whole. They shared the view that many sales statistics had maintained their uptrend, and that demand for durable consumer goods, which exhibited a protracted decline following the front-loaded increase, had almost bottomed out for automobile sales and had started picking up moderately for sales of household electrical appliances. Members concurred that private consumption was likely to remain resilient, and the effects of the decline in demand following the front-loaded increase were likely to dissipate gradually. Meanwhile, many members noted that relatively weak developments had recently been observed in indicators of consumer sentiment. As background to this, some members expressed the opinion that this might be attributable to a decline in real income due to a rise in prices of food and other items, reflecting the depreciation of the yen, and to the consumption tax hike. One of these members added that real wages would likely clearly turn positive on a year-on-year basis, as the effects of price increases associated with the consumption tax hike would dissipate from fiscal 2015. Some members expressed the view that consumer sentiment was likely to improve, given that the employment and income situation had been improving steadily, winter bonus payments seemed to have been increasing, and moves toward wage increases in 2015 were expected to make progress.

Members shared the recognition that housing investment, which had continued to decline following the front-loaded increase, had recently started to bottom out and was projected to regain its resilience gradually.

Members concurred that industrial production had started to bottom out, due in part to the progress in inventory adjustments, and was likely to resume its moderate increase. Some members pointed out that the production forecast index and interviews with firms suggested that production was expected to increase moderately.

As for prices, members concurred that, excluding the direct effects of the consumption tax hike, the year-on-year rate of increase in the CPI (all items less fresh food) was around 1 percent and likely to be at around the current level for the time being. Many members expressed the view that the earlier decline in crude oil prices was likely to exert downward pressure on the CPI for the time being. Some of these members pointed out that, excluding the direct effects of the consumption tax hike, the year-on-year rate of increase in the CPI might hover below 1 percent through the first half of 2015. Many members, however, expressed the recognition that the decline in crude oil prices would have positive effects on economic activity and, from a somewhat longer-term perspective, would likely push up the trend inflation through an improvement in the output gap. Members shared the view that inflation expectations had been rising on the whole from a somewhat longer-term perspective.

B. Financial Developments

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 agreed that firms' financial positions had been favorable, as firms continued to see financial institutions' lending attitudes as being on an improving trend and issuing conditions for CP and corporate bonds continued to be favorable. They shared the view that firms' credit demand had been increasing moderately, and that the amount outstanding of bank lending, including that to small firms, had been increasing moderately.

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.

Many members shared the assessment that quantitative and qualitative monetary easing (QQE) continued to exert its intended effects after the Bank had decided to expand the QQE at the Monetary Policy Meeting held on October 31, 2014. Specifically, these members expressed the recognition that long-term interest rates in Japan had been declining moderately while inflation expectations had been rising from a somewhat longer-term perspective, and thus real interest rates were trending downward. They continued that such developments had been underpinning firms' and households' spending.

With regard to the relationship between the decline in crude oil prices and the conduct of monetary policy, some members noted that some market participants regarded the expansion of the QQE as a direct response to the decline in crude oil prices, and that there was speculation about additional monetary easing in view of a subsequent further decline in crude oil prices. Most members expressed the recognition that the expansion had been implemented not to directly respond to the decline in crude oil prices but to pre-empt manifestation of the risk that conversion of the deflationary mindset would be delayed, in a situation where the rate of increase in prices had not accelerated in the short term due to somewhat weak developments in demand and the decline in crude oil prices. One member said that the primary focus should be on the underlying trend in prices when considering the future conduct of monetary policy, and that the key was developments in inflation expectations in a broad context.

Regarding inflation expectations, members expressed the recognition that it was important not only to assess market indicators and the results of surveys such as those conducted on economists but also to capture firms' and households' views on prices as well as a change in behavior based on such views. On this basis, with regard to developments in inflation expectations after the expansion of the QQE, many members expressed the view that there had been steady progress in the conversion of the deflationary mindset despite the further drop in crude oil prices and the decline in the actual inflation rate. Some members expressed the recognition that firms' and households' behavior had started to change, as seen, for example, in the fact that (1) the Japanese Trade Union Confederation (Rengo) had released the guidelines for wage negotiations in spring 2015, which called for a base pay increase of more than 2 percent; and (2) the statement on government-labor-management initiatives for maintaining a positive cycle of the economy -- released on December 16, 2014 -- had clarified that the business community would exert their full efforts to achieve wage increases. On the other hand, one member said that, based on the experience of 2014, one should not have high hopes for positive effects from the results of wage negotiations at major firms on future price developments. A few members expressed the view that market indicators of inflation expectations such as the break-even inflation rates had recently declined slightly amid their global downtrend following the fall in crude oil prices; however, the rates of decline in these indicators in Japan were smaller than those in Europe and the United States due in part to the effects of the expansion of the QQE. Some members said that, according to surveys conducted on households, firms, and economists, medium- to long-term inflation expectations had generally been maintained, and the December 2014 *Tankan* had shown that firms continued to expect a rise in the inflation rate.

With respect to the effects on prices of the decline in crude oil prices, members shared the following view: (1) the decline would exert downward pressure on prices in the short term; (2) on the other hand, from a somewhat longer-term perspective, the decline would have positive effects on economic activity and would exert upward pressure on the underlying trend in prices; and (3) downward pressure on prices in the short term on a year-on-year basis would dissipate eventually. On this basis, many members said that, if the conversion of the deflationary mindset continued, the decline in crude oil prices would eventually push up the inflation rate. Members expressed the recognition that the Bank should continue to clearly communicate such thinking regarding the effects on prices of the crude oil price decline.

Based on this discussion, regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, most members expressed the view 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 80 trillion yen.

With regard to <u>the asset purchases</u>, most members expressed the recognition that it also was appropriate for the Bank to continue with the current guideline. Specifically, these members confirmed the following. First, the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 80 trillion yen. With a view to encouraging a decline in interest rates across the entire yield curve, the Bank would conduct purchases in a flexible manner in accordance with financial market conditions. The average remaining maturity of the Bank's JGB purchases would be about 7-10 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 annual paces of about 3 trillion yen and about 90 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 future conduct of monetary policy, many members shared the recognition that the Bank would continue with the QQE, 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 agreed that, even though monthly movements in the CPI tended to draw attention in terms of the Bank's conduct of monetary policy in a situation where downward pressure from the decline in crude oil prices continued, it was important to grasp the underlying trend in prices by carefully examining developments such as those in the output gap, inflation expectations, and wages. A few members -- noting that some official statistics employed the CPI for all items less imputed rent to deflate such figures as wages -- expressed the view that, in assessing price developments, it should be noted that imputed rent had recently been exerting downward pressure on the CPI, partly reflecting changes in the environment surrounding the housing market.

Meanwhile, one member said that -- given that downward pressure on the entire yield curve brought about by the QQE had strengthened further -- when examining risks, it was necessary to pay even closer attention to the effects this would have on financial institutions' business conditions and the broadly-defined settlement system.

A different member expressed the view that, if a rise were to occur in markets' anticipation that the QQE 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, this member argued that (1) the Bank should change the guidelines for money market operations and asset purchases back to those employed before the expansion of the QQE; and (2) with regard to the future conduct of monetary policy, the Bank should reconsider the time frame for achieving the price stability target and change the expression representing the Bank's commitment by stating that the time frame for continuing the QQE should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner.

Some members expressed the view that the downgrading of JGBs had had limited effects on the JGB market thus far. Nevertheless, these members added that it was necessary to carefully monitor how the downgrading of the credit ratings of financial institutions and nonfinancial firms in Japan following that of JGBs would affect their funding in foreign currencies and compliance with international financial regulations. Meanwhile, some members reaffirmed that, in order to maintain the credibility at home and abroad of Japan's fiscal management, they expected the government to continue to steadily promote measures aimed at establishing a sustainable fiscal structure.

IV. Remarks by Government Representatives

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

(1) The second preliminary estimate of the real GDP growth rate for the July-September quarter of 2014 -- which had been released on December 8 -- was minus 1.9 percent on an annualized quarter-on-quarter basis, having been revised downward from the first preliminary estimate. Meanwhile, regarding the current state of the economy, the government acknowledged that the economy was on a moderate recovery given that positive developments continued to be observed. For example, the number and compensation of employees had increased and firms' fixed investment plans for fiscal 2014 had been revised upward in the December 2014 *Tankan* released on December 15.

(2) With a view to maintaining a positive cycle of the economy accompanying a rise in wages, the government had held the Government-Labor-Management Meeting for Realizing a Positive Cycle of the Economy on December 16 and formed a common understanding with labor and management, as it had done in 2013. Based on this common understanding, the government would continue to proceed with coordinated measures to overcome deflation. With regard to attaining fiscal soundness, the government would make the maximum possible effort during the process of budget formulation to achieve the target of halving its primary balance deficit relative to GDP by fiscal 2015. It also would resolutely stay the course toward its goal of generating a surplus in the primary balance for fiscal 2020 and draw up concrete plans by the summer of 2015 for achieving this goal. The government would continue to aim to achieve economic revitalization and fiscal consolidation simultaneously.

(3) The government expected the Bank to continue to steadily pursue the QQE and achieve the price stability target of 2 percent at the earliest possible time.

The representative from the Cabinet Office made the following remarks.

(1) The second preliminary estimate of the real GDP growth rate for the July-September quarter of 2014 -- which had been released on December 8 -- was minus 1.9 percent on an annualized quarter-on-quarter basis, registering negative growth for the second consecutive quarter. Regarding the current state of the economy, however, the government acknowledged that the economy remained on a moderate recovery given that economic activity continued to see positive developments, such as the increase in compensation of employees in a situation where corporate profits were at high levels. The decline in crude oil prices was expected to lead to an improvement in the trade balance and the terms of trade as well as to a positive contribution to the GDP deflator, thereby exerting positive effects on the economy as a whole. Taking this into consideration, the government deemed it necessary to closely monitor future price developments.

(2) Although the government had decided to postpone raising the consumption tax rate to 10 percent, it would make sure the increase was implemented in April 2017 and never "lower the flag" of attaining fiscal soundness. During the process of formulating the budget for fiscal 2015, the government would make the maximum possible effort to steadily achieve the target of halving its primary balance deficit relative to GDP by fiscal 2015. It would also resolutely stay the course toward its goal of generating a surplus in the primary balance for fiscal 2020. By drawing up concrete plans by the summer of 2015 to achieve this goal, the government would clarify the path toward realizing both economic revitalization and fiscal soundness.

(3) The government would continue to give highest priority to the economy and implement economic measures -- mainly for the growth strategy -- more strongly and boldly. At the Government-Labor-Management Meeting for Realizing a Positive Cycle of the Economy held on December 16, the government had reached an agreement with labor and management on the efforts toward maintaining a positive cycle of the economy. It was established in the agreement that the business community would exert their full efforts to achieve wage increases. Moreover, in response to the instructions from the

prime minister, the government was currently working on drawing up plans for a new economic stimulus package, particularly to boost private consumption and to improve regional economies, and would develop it by the end of 2014. During the latest extraordinary session of the Diet, the government had obtained the Diet's approval of two bills related to building up local regions. The government would aim to formulate a "long-term vision" and a "comprehensive strategy" by the end of 2014. It expected the Bank to steadily continue its efforts to achieve the price stability target of 2 percent.

V. Votes

A. Vote on the Guideline for Money Market Operations

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

The Policy Board decided the proposal by a majority vote.

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

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

> The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 80 trillion yen.

2. A public statement will be decided separately.

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

B. Vote on the Guideline for Asset Purchases

To reflect the majority view of the members, the chairman formulated the following proposal to continue with the guideline for asset purchases and put it to a vote: (1) to purchase JGBs so that their amount outstanding would increase at an annual pace of about 80 trillion yen, to conduct purchases in a flexible manner in accordance with financial market conditions -- with a view to encouraging a decline in interest rates across the entire yield curve -- and to make the average remaining maturity of the Bank's JGB purchases about 7-10 years; (2) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 3 trillion yen and about 90 billion yen, respectively; and (3) to maintain the amounts outstanding of CP and corporate bonds at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

The Policy Board decided the proposal by a majority vote.

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

VI. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy, and formed a majority view. Mr. T. Kiuchi, however, formulated a proposal, and thus two proposals were submitted.

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T. Kiuchi proposed changing the current expression of the Bank's future monetary policy stance that "the Bank will continue with the QQE, 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 the QQE as an intensive measure with a time frame of about two years, and thereafter will review the monetary easing measures in a flexible manner." The proposal was then put to a vote.

The proposal 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.

B. The Chairman's Policy Proposal

The chairman formulated the Statement on Monetary Policy, and put it to a vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment 1).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of November 18 and 19, 2014 for release on December 25, 2014.

VIII. Approval of the Scheduled Dates of the Monetary Policy Meetings in January-December 2015

At the end of the meeting, the Policy Board approved unanimously the dates of the Monetary Policy Meetings to be held in the period of January-December 2015 for immediate release (see Attachment 2).

Attachment 1

December 19, 2014

Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by an 8-1 majority vote, to set the following guideline for money market operations for the intermeeting period:[Note 1]

   The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 80 trillion yen.

2. With regard to the asset purchases, the Bank decided, by an 8-1 majority vote, to continue with the following guidelines:[Note 2]

   a) The Bank will purchase Japanese government bonds (JGBs) so that their amount outstanding will increase at an annual pace of about 80 trillion yen. With a view to encouraging a decline in interest rates across the entire yield curve, the Bank will conduct purchases in a flexible manner in accordance with financial market conditions. The average remaining maturity of the Bank's JGB purchases will be about 7-10 years.

   b) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at annual paces of about 3 trillion yen and about 90 billion yen respectively.

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

3. Japan's economy has continued to recover moderately as a trend, and effects such as those of the decline in demand following the front-loaded increase prior to the consumption tax hike have been waning on the whole. Overseas economies -- mainly advanced economies -- have been recovering, albeit with a lackluster performance still seen in part. In this situation, exports have shown signs of picking up. Business fixed investment has been on a moderate increasing trend as corporate profits have improved. Public investment has more or less leveled off at a high level. Private consumption has remained resilient as a trend with the employment and income situation improving steadily, and the effects of the decline in demand following the front-loaded increase have been waning on the whole. Housing

investment, which continued to decline following the front-loaded increase, has recently started to bottom out. Against the backdrop of these developments in demand both at home and abroad, industrial production has started to bottom out, due in part to the progress in inventory adjustments. Business sentiment has generally stayed at a favorable level, although some cautiousness has been observed. Meanwhile, financial conditions are accommodative. On the price front, the year-on-year rate of increase in the consumer price index (CPI, all items less fresh food), excluding the direct effects of the consumption tax hike, is around 1 percent. Inflation expectations appear to be rising on the whole from a somewhat longer-term perspective.

4. With regard to the outlook, Japan's economy is expected to continue its moderate recovery trend, and the effects such as those of the decline in demand following the front-loaded increase prior to the consumption tax hike are expected to dissipate. The year-on-year rate of increase in the CPI is likely to be at around the current level for the time being.

5. Risks to the outlook include developments in the emerging and commodity-exporting economies, the prospects regarding the debt problem and the risk of low inflation rates being protracted in Europe, and the pace of recovery in the U.S. economy.

6. Quantitative and qualitative monetary easing (QQE) has been exerting its intended effects, and the Bank will continue with the QQE, 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.[Note 3]

[Note 1] Voting for the action: 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. Voting against the action: Mr. T. Kiuchi. The member voting against the action considered that the guideline for money market operations before the decision regarding the "Expansion of the Quantitative and Qualitative Monetary Easing" on October 31, 2014 was appropriate.

[Note 2] Voting for the action: 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. Voting against the action: Mr. T. Kiuchi. The member voting against the action considered that the guideline for asset purchases before the decision regarding the "Expansion of the Quantitative and Qualitative Monetary Easing" on October 31, 2014 was appropriate.

[Note 3] Mr. T. Kiuchi proposed that the Bank will aim to achieve the price stability target of 2 percent in the medium to long term and designate the QQE as an intensive measure with a time frame of about two years. The proposal was defeated by an 8-1 majority vote. Voting for the proposal: Mr. T. Kiuchi. Voting 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.

Attachment 2

December 19, 2014

Bank of Japan

Scheduled Dates of Monetary Policy Meetings in January-December 2015

	Date of MPM	Publication of MPM Minutes	Publication of Outlook Report (The Bank's View)	(Reference) Publication of Monthly Report
Jan. 2015	20 (Tues.), 21 (Wed.)	Feb. 23 (Mon.)	--	22 (Thurs.)
Feb.	17 (Tues.), 18 (Wed.)	Mar. 20 (Fri.)	--	19 (Thurs.)
Mar.	16 (Mon.), 17 (Tues.)	Apr. 13 (Mon.)	--	18 (Wed.)
Apr.	7 (Tues.), 8 (Wed.)	May 8 (Fri.)	--	9 (Thurs.)
	30 (Thurs.)	May 27 (Wed.)	30 (Thurs.)	--
May	21 (Thurs.), 22 (Fri.)	June 24 (Wed.)	--	25 (Mon.)
June	18 (Thurs.), 19 (Fri.)	July 21 (Tues.)	--	22 (Mon.)
July	14 (Tues.), 15 (Wed.)	Aug. 12 (Wed.)	--	16 (Thurs.)
Aug.	6 (Thurs.), 7 (Fri.)	Sept. 18 (Fri.)	--	10 (Mon.)
Sept.	14 (Mon.), 15 (Tues.)	Oct. 13 (Tues.)	--	16 (Wed.)
Oct.	6 (Tues.), 7 (Wed.)	Nov. 5 (Thurs.)	--	8 (Thurs.)
	30 (Fri.)	Nov. 25 (Wed.)	30 (Fri.)	--
Nov.	18 (Wed.), 19 (Thurs.)	Dec. 24 (Thurs.)	--	20 (Fri.)
Dec.	17 (Thurs.), 18 (Fri.)	To be announced	--	21 (Mon.)

Note: The time of release will be, in principle, as follows.

MPM Minutes will be released at 8:50 a.m.

Outlook for Economic Activity and Prices (Outlook Report):
"The Bank's View" in the Outlook Report will be released at 3:00 p.m., and the full text at 2:00 p.m. on the next business day. As an exception to this principle, the full text of the October 2015 Outlook Report will be released at 2:00 p.m. on October 31 (Sat.), 2015.

Monthly Report of Recent Economic and Financial Developments (Monthly Report):

The Japanese original and the English translation for summary will be released at 2:00 p.m. (the English translation for the full text will be published at 4:30 p.m. on the next business day).