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December 26, 2016

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 31 and November 1, 2016

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Monday, October 31, 2016, from 2:00 p.m. to 3:27 p.m., and on Tuesday, November 1, from 9:00 a.m. to 11:48 a.m.[1]

Policy Board Members Present

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

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

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

Mr. T. Sato

Mr. T. Kiuchi

Mr. Y. Harada

Mr. Y. Funo

Mr. M. Sakurai

Ms. T. Masai

Government Representatives Present

Mr. T. Otsuka, State Minister of Finance, Ministry of Finance[2]

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

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

Mr. S. Habuka, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. S. Kuwabara, Executive Director

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

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

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on December 19 and 20, 2016 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. T. Otsuka and T. Ochi were present on November 1.

[3] Messrs. M. Ota and S. Habuka were present on October 31.

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

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

Mr. K. Nakamura, Head of Economic Research Division, Research and Statistics Department

Mr. S. Nagai, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. R. Yanagihara, Director-General, Secretariat of the Policy Board

Mr. H. Nakamoto, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. I. Muto, Senior Economist, Monetary Affairs Department

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

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

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the short-term policy interest rate of minus 0.1 percent and the target level of the long-term interest rate, both decided at the previous meeting on September 20 and 21, 2016, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, 10-year JGB yields had been stable generally at around 0 percent in negative territory, and the shape of the yield curve for JGBs remained roughly the same as at the time of the previous meeting.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had generally been in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.02 to minus 0.06 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had been in the range of around minus 0.3 to minus 0.4 percent.

The Nikkei 225 Stock Average remained on an increasing trend, mainly due to the depreciation of the yen and a waning of investors' risk aversion, and was moving at around 17,500 yen recently. In the foreign exchange market, the yen had appreciated somewhat against the U.S. dollar immediately after the previous meeting. Thereafter, it had depreciated, reflecting increased expectations for a possible policy rate hike in the United States by the end of 2016. Meanwhile, the yen had been essentially flat against the euro.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow at a moderate pace, but the pace of growth had somewhat decelerated, mainly in emerging economies.

The U.S. economy had been on a recovery trend, assisted by firmness in the employment and income situation and in household spending, although the industrial sector had somewhat lacked momentum, mainly against the background of the slowdown in emerging economies. As for prices, the year-on-year rate of increase in the personal

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

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

The Bank will purchase JGBs so that 10-year JGB yields will remain more or less at the current level (around zero percent).

consumption expenditure (PCE) deflator for all items excluding food and energy had been in the range of 1.5-2.0 percent. That for all items had been at around 1.0 percent, mainly due to the negative contribution of energy prices.

The European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness. With regard to prices, the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items had been at around 0.5 percent, mainly due to the decline in energy prices, but that for all items excluding energy and unprocessed food had been at around 1 percent. Meanwhile, economic activity in the United Kingdom continued to recover, but the pace of recovery had slowed somewhat. While indicators of firms' and households' sentiment, which had worsened at one point after the referendum on the United Kingdom's membership in the European Union (EU), had rebounded, indicators related to housing investment and business fixed investment had deteriorated. Under such circumstances, the extent to which the United Kingdom's vote to leave the EU would be a burden on its economic activity remained uncertain.

With regard to emerging economies, the Chinese economy remained slightly subdued, particularly in exports and production, but maintained its stable growth on the whole. In India, the economy had been growing steadily, particularly in domestic demand, partly in reflection of expectations for structural reforms and of monetary easing effects. Economic activity in the NIEs and the ASEAN countries had been somewhat subdued as exports and production continued to be weak on the whole, but domestic demand had been resilient due to the effects of economic stimulus measures. Economic activity in Brazil and Russia remained severe but had generally bottomed out, mainly due to a halt in the decline in commodity prices. As for prices in emerging economies, inflation rates had been more or less flat at low levels in many countries and regions. Those in Brazil and Russia remained at high levels but had been declining due to a pause in the depreciation of their currencies.

Global financial markets had generally been calm, and long-term interest rates in the United States had risen somewhat as a possible policy rate hike by the end of 2016 had been factored in gradually by the market. Stock prices in advanced and emerging economies had been moving at high levels. Nevertheless, the pound sterling had depreciated substantially and prices of U.K. government bonds had declined significantly, both reflecting heightened uncertainty associated with the United Kingdom's vote to leave the EU, and stock prices of some European banks had declined temporarily.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy continued its moderate recovery trend, although exports and production had been sluggish, due mainly to the effects of the slowdown in emerging economies.

Exports had been more or less flat. Those to advanced economies, mainly automobile-related, remained on a steady increasing trend, albeit with temporary fluctuations, whereas those to emerging economies had been sluggish, especially of capital goods such as machine tools and ships. Exports were projected to generally remain more or less flat for the time being as the slowdown in overseas economies and the past appreciation of the yen exerted downward pressure. Thereafter, they were projected to increase moderately as the effects of the slowdown in overseas economies and the appreciation of the yen were expected to gradually wane.

The decline in public investment had leveled off. Such investment was likely to rise moderately, particularly in that related to the disaster relief construction and a variety of infrastructure enhancements, underpinned by the implementation of the supplementary budget.

Business fixed investment had been on a moderate increasing trend as corporate profits had been at high levels. According to the September 2016 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), business sentiment had generally stayed at a favorable level on the back of corporate profits remaining at high levels. Against this backdrop, firms had generally maintained their solid investment plans in the September *Tankan*, including those of large manufacturers, for which profit projections had deteriorated as the expected exchange rate had shifted toward appreciation of the yen against the U.S. dollar. Machinery orders and planned expenses for construction starts -- both of which were leading indicators of business fixed investment -- continued a moderate increasing trend, albeit with some fluctuations. Business fixed investment, mainly in manufacturing firms, was likely to be negatively affected temporarily by the slowdown in overseas economies and the past yen appreciation. However, it was likely to continue to see a moderate uptrend, mainly on the back of corporate profits at high levels.

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

Private consumption had been resilient against the background of steady improvement in the employment and income situation, although relatively weak developments had been seen in some indicators. The consumption activity index had been somewhat weak in the first half of 2016, but had started to pick up recently on the back of resilience in stock prices and a steady improvement in employee income, despite being affected by bad weather conditions. Consumer sentiment indicators had picked up on the whole. Private consumption was expected to increase its resilience gradually, and thereafter was likely to increase moderately, with the employment and income situation continuing to improve steadily.

Housing investment continued picking up, underpinned partly by accommodative financial conditions.

Industrial production continued to be more or less flat due to the slowdown in emerging and commodity-exporting economies. As for the outlook, it was projected to generally remain more or less flat for the time being. Thereafter, as the effects of the slowdown in overseas economies waned and those of the set of stimulus measures became evident, industrial production was likely to head toward a moderate increase, reflecting a rise in final demand at home and abroad.

As for prices, the rate of decline in the producer price index (PPI) relative to three months earlier had been on a decelerating trend when fluctuations were smoothed out, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the consumer price index (CPI) for all items less fresh food had been slightly negative. The rate of increase for all items less fresh food and energy had registered 0.2 percent year-on-year for September. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to be slightly negative or about 0 percent for the time being, due to the effects of the decline in energy prices.

2. Financial environment

Financial conditions were highly accommodative.

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

Firms' funding costs had been hovering at extremely low levels. With regard to credit supply, financial institutions' lending attitudes -- as perceived by firms -- had been highly accommodative. Issuing conditions for CP and corporate bonds had been favorable. Firms' credit demand had been increasing moderately, such as for funds related to mergers and acquisitions, as well as for funds for business fixed investment. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been in the range of 2.0-2.5 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds had accelerated. Firms' financial positions had been favorable.

The monetary base had been increasing at a high year-on-year growth rate in the range of 20-25 percent, and its amount outstanding as of end-September was 413 trillion yen, of which the ratio to nominal GDP was 82 percent. The year-on-year rate of growth in the money stock had been around 3.5 percent.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments and the October 2016 *Outlook for Economic Activity and Prices*

A. Economic Developments

Members shared the recognition that global financial markets had generally been calm, although the pound sterling had depreciated substantially reflecting heightened uncertainty associated with the United Kingdom's vote to leave the EU. One member said that market participants' risk sentiment had improved, and expectations had increased for a possible policy rate hike in the United States by the end of 2016. On this basis, members shared the recognition that due attention should continue to be paid to developments in global financial markets, given that there remained various uncertainties surrounding overseas economies.

Members shared the recognition that overseas economies continued to grow at a moderate pace, but the pace of growth had somewhat decelerated, mainly in emerging economies. They continued that the impact of the United Kingdom's vote to leave the EU on the global economy had been limited so far. As for the outlook, members concurred that overseas economies were likely to remain slightly subdued for some time but subsequently see moderate increases in their growth rates, as it was likely that advanced economies would continue to realize steady growth and emerging economies would move out of their deceleration phase on the back of the developments in advanced economies and emerging economies' policy effects. Some members pointed to the fact that the projection for global growth presented in the *World Economic Outlook* released in October 2016 by the International Monetary Fund (IMF) had not been revised downward, and mentioned that it seemed to indicate that the global economy had been picking up. Some members then expressed the view that there were not a few risk factors, such as the following: (1) the outcome of the presidential election in the United States; (2) concern over some European financial institutions; (3) the possibility that the United Kingdom leaving the EU would result in a so-called hard Brexit; (4) the problem of excess production capacity in emerging economies; and (5) future developments relating to the agreement among oil-exporting economies to reduce their production levels.

With regard to developments in overseas economies by region, members concurred that the U.S. economy had been on a recovery trend, assisted by firmness in the employment and income situation and in household spending, although the industrial sector had somewhat lacked momentum, mainly against the background of the slowdown in emerging economies. One member expressed the view that the economy had been on a stable growth path, with the robust performance of the nonmanufacturing sector offsetting the weak performance of the manufacturing sector that reflected in particular the sluggishness in investment related to energy. As for the outlook, members shared the view that the economy was likely to continue to grow, mainly in private demand, led by the firmness in household spending, reflecting accommodative financial conditions, although exports and production were likely to lack momentum in the short run.

Members shared the recognition that the European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness, mainly due to the effects of the slowdown in emerging economies. With respect to economic activity in the United Kingdom, one member noted that production had been resilient as consumer sentiment, which had worsened sharply at one point after the referendum, had recovered to its pre-referendum level. As for the outlook, members concurred that the economy would likely continue to see a moderate recovery, mainly on the back of the improvement in the employment and income situation under accommodative financial conditions, although external demand was likely to lack momentum.

Members agreed that the Chinese economy remained slightly subdued, particularly in exports and production, but maintained its stable growth on the whole. As for the outlook, they shared the view that the economy was likely to broadly follow a stable growth path as authorities proactively carried out measures to support economic activity, although the growth pace was likely to be somewhat slower, mainly in exports and production.

Members shared the view that emerging economies had been decelerating somewhat, mainly in exports and production. One member said that somewhat positive factors had been observed, such as the pick-up in exports and production -- particularly of IT-related goods -- although it was necessary to carefully monitor further developments in relevant data. As for the outlook, members concurred that emerging economies were likely to remain somewhat subdued, but that the growth rates subsequently were likely to increase gradually, due mainly to the effects of the economic stimulus measures both on the monetary and fiscal fronts and the spread of the effects of the recovery in advanced economies.

Members concurred that financial conditions in Japan were highly accommodative. They shared the view that, under Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control, firms' funding costs had been hovering at extremely low levels.

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

With regard to economic activity, members shared the recognition that the economy continued its moderate recovery trend, although exports and production had been sluggish, due mainly to the effects of the slowdown in emerging economies. A few members expressed the view that the combination of the government's large-scale stimulus measures and monetary easing measures would underpin the virtuous cycle from income to spending and thereby contribute to a rise in the economic growth rate. A different member noted that (1) the appreciation of the yen, which was considered to be a cause for concern for Japan's economy at present, had reversed to depreciation recently, and if the Federal Reserve raised its policy rate in December 2016 on the back of the continued steady growth in the U.S.

economy, the yen was likely to shift from the appreciation trend seen so far to a depreciation trend, and (2) the government's stimulus measures were likely to generate positive effects. The member then expressed the view that the recovery of Japan's economy had become more sustainable.

Members agreed that Japan's exports had been more or less flat, due mainly to the effects of the slowdown in emerging economies. As for the outlook, they shared the view that, although exports were likely to remain more or less flat for the time being, they were likely to increase moderately thereafter as the effects of the slowdown in overseas economies and of the past appreciation of the yen would probably gradually wane.

Members agreed that business fixed investment had been on a moderate increasing trend as corporate profits had been at high levels. They shared the view that such investment was likely to continue to see a moderate uptrend, mainly on the back of corporate profits at high levels. A few members pointed out that firms had maintained a positive stance for their fixed investment plans, as suggested by the September 2016 *Tankan*. Regarding corporate profits, one of these members noted that -- while firms continued to revise the exchange rates used for their business planning toward appreciation -- the fact that firms had maintained their projections for the ratio of current profits to sales at fairly high levels was supportive of business fixed investment going forward. On the other hand, one member said that, even though business fixed investment plans had been maintained at high levels, they would not necessarily be implemented as planned, considering past trends. A different member, while noting that polarization had been observed between firms that were proactive in their fixed investment and those that were reluctant, pointed out that a challenge was to increase the number of proactive firms. The member continued that it was important to improve the business environment in various ways with a view to increasing investment opportunities, such as enhancing mobility in the labor market, supporting business succession, and promoting innovation.

As for the employment and income situation, members shared the view that employee income had increased moderately as supply-demand conditions in the labor market continued to improve steadily, and that it was likely to continue to do so as labor market conditions kept improving and corporate profits remained at high levels. On this basis, one member expressed the view that, although nominal wages had increased moderately, the pace of increase was still slow in view of the tight labor market conditions.

Members agreed that private consumption had been resilient against the background of steady improvement in the employment and income situation, although relatively weak developments had been seen in some indicators. Some members expressed the view that, although the effects of bad weather had been seen, the actual condition of private consumption had not been weak and had started to bottom out recently, as evident from the pick-up in consumer sentiment indicators. In the outlook, many members shared the view that private consumption was likely to increase its resilience gradually as the employment and income situation continued to improve steadily. One member said that the government's provision of benefits in the set of stimulus measures, through supporting disposable income, would also contribute to an increase in consumption. A few members, including this member, noted that the propensity to consume had continued to decline but was likely to rise, mainly because the decline seemed to have been partly due to the effects of bad weather conditions and the negative wealth effects brought about by the decline in stock prices.

As for housing investment, members shared the recognition that it continued picking up, underpinned partly by accommodative financial conditions.

Members shared the recognition that industrial production continued to be more or less flat due to the slowdown in emerging and commodity-exporting economies. As for the outlook, they agreed that it was likely to generally remain more or less flat as the slowdown in overseas economies exerted downward pressure.

As for prices, members concurred that the year-on-year rate of change in the CPI (all items less fresh food) had been slightly negative, and that it was likely to remain so or be about 0 percent for the time being. A few members pointed out that the underlying trend in inflation had been weakening in a situation where firms' price-setting behavior had become cautious, reflecting the recent relative weakness in consumption.

B. Outlook for Economic Activity and Prices

With regard to the baseline scenario of the outlook for Japan's economic activity, members shared the view that, although sluggishness was likely to remain in exports and production for some time, the economy was likely to expand moderately thereafter. Members shared the recognition that domestic demand was likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, on the back of highly accommodative financial conditions and fiscal spending through the government's large-scale stimulus measures. They continued that exports were likely to start increasing moderately since overseas economies would probably see gradual increases in their growth rates. In this situation, they concurred that Japan's economy was likely to grow at a pace above its potential through the projection period of fiscal 2016-2018. Members agreed that the projected growth rates were more or less unchanged compared with those presented in the July 2016 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report).

Members shared the view that business fixed investment was likely to continue to see a moderate increasing trend, supported by accommodative financial conditions, heightened growth expectations, and increases in Olympic Games-related demand. They also agreed that private consumption would probably increase moderately on the back of an improvement in employee income. In addition, members shared the recognition that public investment was likely to increase through fiscal 2017, due to a set of stimulus measures, and thereafter remain at a relatively high level with Olympic Games-related demand.

In terms of the outlook for prices, most members shared the view that (1) the year-on-year rate of change in the CPI was likely to increase toward 2 percent in the second half of the projection period as the output gap improved and medium- to long-term inflation expectations rose, and (2) the timing of the year-on-year rate of change in the CPI reaching around 2 percent would likely be around fiscal 2018 -- that is, at the end of the projection period. These members agreed that, compared with the projections presented in the July 2016 Outlook Report, the projected rate of increase in the CPI was somewhat lower, mainly due to medium- to long-term inflation expectations having remained in a weakening phase. On the other hand, a few other members expressed the recognition that the rate of change in the CPI would not reach around 2 percent during the projection period. One of these members commented that the rate of change in the CPI was unlikely to reach around 2 percent in the relatively near future, even beyond the projection period covered in the October 2016 Outlook Report.

Members discussed medium- to long-term inflation expectations and the output gap, both of which were factors that formed the background to these projections. First, they shared the view that medium- to long-term inflation expectations remained in a weakening phase since summer 2015 as the adaptive formation mechanism of inflation expectations had played a large role, with the observed inflation rate being about 0 percent or slightly negative. As for the outlook, most members agreed that firms' price-setting stance was likely to revert to raising prices as private consumption would probably head toward a moderate increase, and their wage-setting stance was likely to shift toward raising wages driven by the tightening of labor market conditions. These members shared the recognition that medium- to long-term inflation expectations were likely to follow an increasing trend and gradually converge to around 2 percent, because of the following two factors: (1) in terms of the adaptive component, the observed inflation rate was likely to rise, mainly due to the dissipation of the downward pressure of energy prices going forward, and (2) in terms of the forward-looking component, the Bank would pursue monetary easing through its strong commitment to achieving the price stability target. One member expressed the view that the shift toward depreciation of the yen in the foreign exchange market would also contribute to rises in the observed inflation rate and inflation expectations. In terms of raising inflation expectations, a different member pointed out that it was not easy to depart from the adaptive formation mechanism, which had taken hold over a long period, and in order for such a departure to proceed steadily, sustainable economic growth was essential in parallel with the pursuit of monetary easing. On this basis, the member said that a transition to the forward-looking formation mechanism would be expected going forward, because the effects resulting from the set of stimulus measures by the government would also contribute to such a transition. Meanwhile, a few other members expressed a more cautious view on the pace of increase in inflation expectations.

With regard to the output gap, members agreed that this was more or less unchanged on the whole, as the tightening of labor market conditions continued while an improvement in manufacturers' capacity utilization rates had been delayed, mainly against the background of the slowdown in emerging economies. As for the outlook, they shared the recognition that, due in part to the effects resulting from the set of stimulus measures, the tightening of labor market conditions was likely to continue, and capacity utilization rates were likely to increase again as exports and production picked up. They continued that the output gap was therefore likely to move into positive territory through the end of fiscal 2016 and thereafter widen further within that territory.

Members also discussed upside and downside risk factors to the baseline scenario of the outlook for economic activity and prices. Regarding the outlook for economic activity, they noted the following upside and downside risk factors: (1) developments in overseas economies; (2) firms' and households' medium- to long-term growth expectations; and (3) fiscal sustainability in the medium to long term.

As upside and downside risks to prices, members pointed to the following three factors: (1) developments in firms' and households' medium- to long-term inflation expectations; (2) the fact that there were items for which prices were not particularly responsive to the output gap; and (3) developments in foreign exchange rates and international commodity prices going forward.

On this basis, most members shared the recognition that risks to Japan's economic activity and prices were skewed to the downside, especially those concerning overseas economies and developments in medium- to long-term inflation expectations.

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

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

With regard to <u>conducting monetary policy</u>, members agreed that the important criterion was whether the momentum toward achieving the 2 percent price stability target was being maintained, taking account of developments in economic activity and prices as well as financial conditions. On this basis, most members shared the recognition that, with respect to price developments, the momentum toward achieving the price stability target of 2 percent was being maintained. At the same time, these members concurred that the momentum was somewhat weaker than the previous projection in the July 2016 Outlook Report, and thus price developments warranted careful attention going forward. One member said that, because the inflation rate was likely to increase gradually under QQE with Yield Curve Control, the Bank should monitor the policy effects under the current framework for the time being. A different member noted that, as a virtuous cycle in the economy had been in place, the Bank should continue with the current monetary policy so as to contribute to the long-running battle to overcome deflation. Another member expressed the view that an improvement in the output gap brought about by the continuation of the current monetary policy, as well as a reversal of the yen's appreciation trend and a moderate rise in crude oil prices going forward, were likely to raise observed prices and inflation expectations. This member continued that, since the momentum toward achieving the price stability target of 2 percent thereby was likely to be maintained, it was appropriate that the Bank continue with the current monetary policy.

With regard to yield curve control, members shared the view that the yield curve for JGBs had been formed smoothly in line with the guideline for market operations since the previous meeting. Some members noted that market developments in the intermeeting period showed that the new framework had been perceived in a calm manner by market participants. A different member expressed the view that market participants had gained a better understanding of the Bank's policy intentions behind the new framework, partly owing to the Bank's careful communication. One member noted that, although the new framework had been functioning smoothly so far, it was necessary that the Bank continue to monitor closely the results of market operations and financial market reactions, since various developments could take place going forward. A few members pointed out that, in a situation where volatilities in long-term interest rates had decreased further, attention needed to be paid to the functioning of the market. One of these members added that, in order for long-term interest rate control to work effectively, it was important to maintain the credibility in the JGB market through the government's efforts toward establishing sustainable fiscal structures.

On this basis, members discussed the Bank's conduct of outright purchases of JGBs under yield curve control. Most members shared the view that it was appropriate that the Bank continue to conduct JGB purchases aiming to achieve the target level of the long-term interest rate specified by the guideline for market operations while keeping the guideline of the approximate amount of JGBs to be purchased -- that is, an annual pace of increase in the amount outstanding of the Bank's JGB holdings of about 80 trillion yen. A few members expressed the opinion that deleting the description in the Statement on Monetary Policy regarding the guideline of the approximate amount of JGBs to be purchased could be a wrong signal to the market. They continued that, therefore, the Bank should keep this guideline and conduct the purchases of JGBs in a flexible manner. A few members, including one of these members, pointed out that, despite the fact that the Bank -- with the guideline for the approximate amount of JGBs to be purchased -- had actually reduced the amount of its JGB purchases slightly after the previous meeting, such flexible conduct of JGB purchases had been perceived in a calm manner by market participants, as evidenced by the stable developments in long-term interest rates. One member noted that, as the Bank continued to conduct JGB purchases at around the current pace, long-term interest rates would decline further through the stock effect of the Bank's increasing holdings of JGBs, and with this in mind, the amount of JGB purchases would need to be adjusted so that the interest rates remained at the target level. This member then commented that, given that the Bank's operating target was set at the interest rates, the Bank should attach declining importance to the approximate amount of JGBs of about 80 trillion yen in the policy statement in due course. A different member said that, in conducting JGB purchases, the Bank should maintain long-term interest rates at around 0 percent in response to positive shocks on interest rates, and should maintain the annual pace of JGB purchases of about 80 trillion yen, allowing the interest rates to decline below 0 percent in response to negative shocks. On this basis, this member noted that, if the shocks were large and persistent, it was reasonable to discuss a change in the Bank's guideline for market operations at the Monetary Policy Meeting.

Regarding the impacts of monetary policy on the Bank's financial conditions, one member said that it was important for the Bank to clearly explain to the public that these were the result of its monetary policy that aimed to achieve the price stability target of 2 percent. A few members pointed out that a central bank controlled policy interest rates and conducted asset purchases in order to achieve price stability. These members continued that, although a central bank consequently would face fluctuations in its profits in the short run, it would bring about seigniorage -- the profit generated by issuing banknotes as the sole issuer -- in the long run. One of these members added that the Bank already had expanded measures pertaining to provisions for possible losses on bonds transactions in order to smooth out the short-term fluctuation in its profits. Another member said that, if the 2 percent price stability target was achieved and interest rate levels rose accordingly, the amount of seigniorage would be larger.

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

With regard to asset purchases except for JGB purchases, many members shared the recognition that it was appropriate for the Bank to implement the following guideline for the intermeeting period. First, it would purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding would increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. Second, as for CP and corporate bonds, it would maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

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

On this point, one member noted that it was uncertain whether the amount of JGB purchases would decrease going forward under yield curve control. The member then argued that, in conducting monetary policy, the Bank should set the amount of its JGB purchases as the operating target and make sure to reduce it incrementally, as this would make its asset purchases more sustainable and enhance the stability of the market, thereby securing the monetary easing effects seen so far.

A different member said that the Bank should make public the policy reaction function for long-term interest rate control and develop a common understanding through communication with the market and various economic entities.

IV. Remarks by Government Representatives

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

(1) On August 24, 2016, the second supplementary budget for fiscal 2016 was approved by the Diet. This aimed to realize investment for the future, such as improving the childcare environment, increasing the capacity to accommodate foreign visitors, and bringing forward the opening of the entire Linear Chuo Shinkansen line. By implementing this budget in a smooth and appropriate manner, the government would not only stimulate near-term demand but also bring about sustainable economic growth led by private demand.

(2) At this meeting, there were discussions about revising the economic projections in the Outlook Report. The government expected the Bank to continue to work toward achieving the price stability target under QQE with Yield Curve Control, in light of developments in economic activity and prices, as well as financial conditions.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on a moderate recovery, while weakness could be seen recently. As for the outlook, the economy was expected to head toward a moderate recovery, supported partly by the effects of the government's policies, while the employment and income situation continued to improve. However, there were downside risks to the Japanese economy stemming from the slowing down of Asian emerging economies amid the weakness of overseas economies. In addition, attention should be given to the increased uncertainty in overseas economies and the effects of fluctuations in financial markets. In assessing price developments, it was important to comprehensively examine a wide range of indicators, including the GDP deflator.

(2) The prime minister had given instructions to smoothly and steadily implement various economic stimulus measures, including those laid out in the second supplementary budget for fiscal 2016. With regard to the working-style reform, progress had been made with discussions on the nine areas of reform, such as providing equal pay for equal work, considering a regulatory limit on overtime work, providing support for career change or reemployment opportunities, and promoting flexible work styles. The government would continue working on such structural reforms to raise the potential growth rate.

(3) The government expected the Bank to steadily work toward achieving the price stability target of 2 percent, in light of developments in economic activity and prices, as well as

financial conditions. It deemed it important that the Bank fully explain to the public its thinking behind the change in the projected timing of achieving the price stability target of 2 percent.

V. Votes

A. Vote on the Chairman's Policy Proposal on the Guideline for Market Operations

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

The Policy Board decided the proposal by a majority vote.

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

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

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

2. The Bank will purchase JGBs so that 10-year JGB yields will remain at around 0 percent. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases at more or less the current pace -- an annual pace of increase in the amount outstanding of its JGB holdings of about 80 trillion yen -- aiming to achieve the target level of the long-term interest rate specified by the guideline.

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

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

Mr. T. Sato dissented considering that setting the short-term policy interest rate at minus 0.1 percent and the target level of 10-year JGB yields at around 0 percent could lead to holding JGB yields in negative territory up to a maturity of ten years and thus could have an adverse impact on the functioning of financial intermediation. Mr. T. Kiuchi dissented considering that, with a view to maintaining the stability of the JGB market and the functioning of financial intermediation, (1) the short-term policy interest rate should be set at 0.1 percent and (2) the adoption of a target level of a long-term interest rate was not appropriate because it would entail a risk that the Bank might need to further increase the pace of its JGB purchases.

B. Vote on the Chairman's Policy Proposal on the Guideline for Asset Purchases

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

The Policy Board decided the proposal by a majority vote.

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

Mr. T. Sato dissented considering that ETF purchases of about 6 trillion yen annually would be excessive in light of their adverse impact on the pricing mechanism in the stock market and the Bank's financial soundness.

C. Vote on Mr. T. Kiuchi's Policy Proposal on the Guideline for Asset Purchases

Mr. T. Kiuchi proposed that the Bank continue to use amounts of asset purchases as its operating targets and that the guidelines for asset purchases for the intermeeting period be set as follows: (1) to purchase JGBs so that their amount outstanding would increase at an annual pace of about 45 trillion yen, and to make the average remaining maturity of the Bank's JGB purchases about seven years; (2) to purchase ETFs and J-REITs so that their amounts outstanding would increase at annual paces of about 1 trillion yen and about 30 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 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

D. Vote on the Statement on Monetary Policy

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

VI. Discussion regarding the Outlook Report

Members discussed the draft of "The Bank's View" in the October 2016 Outlook Report (consisting of "The Bank's View" and "The Background") and formed a majority view.

Mr. T. Sato, however, formulated a proposal to make the following changes. First, with regard to the outlook for prices, he proposed a new expression that the year-on-year rate of change in the CPI "is likely to be slightly negative or about 0 percent for the time being, and as the aggregate supply and demand balance (the output gap) improves and medium- to long-term inflation expectations rise, it is expected to gradually increase toward 2 percent." Second, he proposed changing the current expression that "the timing of the year-on-year rate of change in the CPI reaching around 2 percent will likely be at the end of the projection period -- that is, around fiscal 2018" to a new expression that "the timing of around 2 percent coming into sight will likely be at the end of the projection period -- that is, around fiscal 2018." Third, with regard to the future conduct of monetary policy, he proposed deleting the expression that "the Bank will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner." The proposal was then put to a vote.

The proposal 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. T. Kiuchi, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

Mr. T. Kiuchi formulated a proposal to make the following changes. First, with regard to the outlook for prices, he proposed a new expression that the year-on-year rate of change in the CPI "is likely to be slightly negative or about 0 percent for the time being, and thereafter increase very moderately." Second, with regard to medium- to long-term inflation expectations, he proposed a new expression that they "are likely to remain stable in the future." Third, with regard to the risk balance, he proposed a new expression that "risks to both economic activity and prices are likely to be generally balanced for the time being." Fourth, with regard to the future conduct of monetary policy, he proposed a new expression that "the Bank will, with the aim to achieve the price stability target of 2 percent in the medium to long term, continue to provide consistent support from the financial side. It will continue with asset purchases and a virtually zero short-term interest rate policy as long as each of these policy measures is deemed appropriate under flexible policy conduct based on the examination from the two perspectives of the monetary policy framework -- that is, (1) the outlook deemed most likely by the Bank and (2) risks considered most relevant to the conduct of monetary policy from a medium- to long-term perspective." 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

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

The Policy Board decided the text of "The Bank's View" by a majority vote. It was confirmed that "The Bank's View" would be released immediately after the meeting on November 1, 2016 and the whole report would be made public on November 2.

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

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

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of September 20 and 21, 2016 for release on November 7.

Attachment

November 1, 2016

Bank of Japan

Statement on Monetary Policy

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

(1) Yield curve control

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

The short-term policy interest rate:

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

The long-term interest rate:

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

(2) Guidelines for asset purchases

With regard to asset purchases other than JGB purchases, the Bank decided, by a 7-2 majority vote, to set the following guidelines. [Note 2]

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

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

[Note 1] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the action: Mr. T. Sato and Mr. T. Kiuchi. Mr. T. Sato dissented considering that setting the short-term policy interest rate at minus 0.1 percent and the target level of 10-year JGB yields at around 0 percent could lead to holding JGB yields in negative territory up to a maturity of 10 years and thus could have an adverse impact on the functioning of financial intermediation. Mr. T. Kiuchi dissented considering that, with a view to maintaining the stability of the JGB market and the functioning of financial intermediation, (1) the short-term policy interest rate should be set at 0.1 percent and (2) the adoption of a target level for a long-term interest rate was not appropriate because it would entail a risk that the Bank might need to further increase the pace of its JGB purchases.

[Note 2] Voting for the action: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai. Voting against the action: Mr. T. Sato and Mr. T. Kiuchi. Mr. T. Sato dissented considering that ETF purchases of about 6 trillion yen annually would be excessive in light of their adverse impact on the pricing mechanism in the stock market and the Bank's financial soundness. Mr. T. Kiuchi proposed that the Bank continue to use amounts of asset purchases as its operating targets and set the guidelines for asset purchases as follows: the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 45 trillion yen, purchase ETFs so that their amount outstanding would increase at an annual pace of about 1 trillion yen, and so on. The proposal was defeated by a majority vote.