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February 3, 2017

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 19 and 20, 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, December 19, 2016, from 2:00 p.m. to 3:31 p.m., and on Tuesday, December 20, from 9:00 a.m. to 11:44 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. M. Kihara, 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 January 30 and 31, 2017 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. M. Kihara and T. Ochi were present on December 20.

[3] Messrs. M. Ota and S. Habuka were present on December 19.

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

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

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

Mr. 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. T. Ninomiya, 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 October 31 and November 1, 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 at around 0 percent, and the shape of the JGB yield curve had been consistent with the guideline for market operations. Meanwhile, with regard to JGB purchases, the Bank, on November 17, had conducted outright purchases through the fixed-rate method (fixed-rate purchase operations) for the first time since its introduction, targeting medium-term JGBs.

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 0.03 to minus 0.06 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had moved further into negative territory and had been at around minus 0.4 percent recently.

The Nikkei 225 Stock Average had increased substantially, reflecting the effects of the depreciation of the yen and the rise in U.S. stock prices, and was moving in the range of 19,000-19,500 yen recently. In the foreign exchange market, the yen had depreciated against the U.S. dollar, mainly due to the rise in U.S. interest rates. The yen had depreciated against the euro as well.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow at a moderate pace, although emerging economies remained sluggish in part.

The U.S. economy had been recovering, particularly in household spending, amid improvement in the employment and income situation. Solid household spending had

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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 at around zero percent.

brought about improvement in domestic-oriented firms' sentiment and firm momentum in their production activity. As for prices, the year-on-year rate of increase in the personal consumption expenditure (PCE) deflator for all items excluding food and energy had been in the range of 1.5-2.0 percent, and that for all items had been at around 1.5 percent.

The European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness. With regard to prices, both the year-on-year rate of change in the Harmonized Index of Consumer Prices (HICP) for all items and that for all items excluding energy and unprocessed food had been in the range of around 0.5-1.0 percent. Meanwhile, economic activity in the United Kingdom had shown a solid recovery, supported by household spending.

With regard to emerging economies, the Chinese economy continued to see 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 weak, but exports had picked up and domestic demand had been resilient due to the effects of economic stimulus measures. Economic activity in Russia remained severe but had generally bottomed out, mainly due to a halt in the decline in commodity prices. Economic activity in Brazil had been weakening. 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 the earlier pause in the depreciation of their currencies.

With respect to global financial markets, in the United States, long-term interest rates and stock prices had risen and the U.S. dollar had appreciated, mainly due to the spread of expectations for economic measures to be taken by the new administration. On the other hand, in emerging economies, many countries experienced depreciations of their currencies and declines in stock prices.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy continued its moderate recovery trend.

Exports had picked up with the effects of the slowdown in emerging economies diminishing. Those to advanced economies, mainly automobile-related, continued to increase steadily, and those to emerging economies -- which had continued to show relatively sluggish movements -- were heading toward a pick-up, especially for electronic parts. Exports were projected to continue picking up as a trend as the growth rates of overseas economies were likely to rise moderately, although a decline following an increase in IT-related demand, particularly for parts for smartphones, was anticipated in the immediate future.

Public investment had been more or less flat. 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 and business sentiment had improved somewhat. According to the December 2016 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), business sentiment had improved, albeit slightly, for the second straight term, mainly on the back of the recent pick-up in exports and increase in public investment orders, in addition to corporate profits remaining at high levels. Against this backdrop, firms had generally maintained their solid investment plans in the December *Tankan*, although the effects of labor shortages had been observed at some firms. 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 as a whole was likely to continue to see a moderate uptrend, mainly on the back of corporate profits at high levels, although the effects of the earlier slowdown in overseas economies and yen appreciation were likely to continue to be seen in manufacturing firms.

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. The consumption activity index had been somewhat weak in the first half of 2016, but had registered an increase of 0.4 percent on a quarter-on-quarter basis in the July-September quarter and 0.6 percent in October relative to that quarter, clearly remaining in positive territory. Positive developments in private consumption had started to be observed recently with the effects of the bad weather coming to an end and of the rise in stock prices, as well as the continued improvement in the employment and income situation. Private consumption was expected to see an increase in its resilience gradually, with the employment and income situation continuing to improve steadily and the wealth effects stemming from the rise in stock prices exerting a positive impact.

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

Industrial production had picked up, reflecting moderate increases in demand both at home and abroad and the progress in inventory adjustments. The pace of increase in production had been maintained, particularly in leading industries such as transport equipment, electronic parts and devices, as well as general-purpose, production and business oriented machinery. Inventory adjustments had progressed for capital goods and producer goods, and an increase in shipments of these goods had tended to lead to a rise in their production. As for the outlook, industrial production was likely to continue picking up as a trend, reflecting increases in demand both at home and abroad, although a decline following the increase in IT-related demand was anticipated in the immediate future.

As for prices, the rate of change in the producer price index (PPI) relative to three months earlier had started to increase moderately, 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 0.3 percent year-on-year for October. 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 at around 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. The year-on-year rate of growth in the money stock had been at around 4 percent.

3. Loan disbursement through the Loan Support Program

In early December 2016, the Bank carried out a new loan disbursement, amounting to 563.0 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 6,039.7 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 69.3 billion yen, and that under the special rules for small-lot investments and loans amounted to 12.505 billion yen. As for the special rules for the U.S. dollar lending arrangement, the outstanding balance of loans came to 17.72 billion dollars.

On December 15, the Bank carried out a new loan disbursement, amounting to 5,397.1 billion yen, under the Fund-Provisioning Measure to Stimulate Bank Lending. The outstanding balance of loans disbursed by the Bank amounted to 32,682.0 billion yen after the new loan disbursement.

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

A. Economic Developments

As for global financial markets, members shared the recognition that, after the U.S. presidential election, stock prices and long-term interest rates in the United States had risen significantly and the U.S. dollar had appreciated, and that the effects of such developments had been spreading to other economies. Members concurred that these developments were attributable to (1) growing expectations that proactive economic policy management to be taken by the new administration in the United States would result in an acceleration in the economy's growth rate and inflation rate, and (2) renewed expectations of a rise in U.S. interest rates following the decision made at the Federal Open Market Committee (FOMC) meeting held on December 13 and 14, 2016 to raise the policy rate. A few members pointed out that improvements in economic fundamentals that had been seen since before the U.S. presidential election, such as the firm growth in the global economy and stabilization of crude oil prices, were at the root of these market reactions. Some members expressed the view that these also were partly led by speculation. On this basis, many members expressed the recognition that due attention should be paid to future developments in global financial markets.

With respect to overseas economies, members agreed that, amid the recent global pick-up in manufacturing, the recovery in advanced economies that had been led by the household sector was spreading to the corporate sector and the slowdown in emerging economies had eased. On this basis, they shared the recognition that overseas economies continued to grow at a moderate pace, although emerging economies remained sluggish in part. Some members pointed out that the global pick-up trend in manufacturing had been clearly reflected in, for example, the improvement in the Purchasing Managers' Index (PMI). As for the outlook, members concurred that overseas economies were likely to see moderate increases in their growth rates, as it was likely that advanced economies would continue to realize steady growth and the recovery in emerging economies gradually would become firm on the back of the developments in advanced economies and emerging economies' policy effects.

With regard to developments in overseas economies by region, members concurred that the U.S. economy had been recovering, particularly in household spending, amid improvement in the employment and income situation, and that the recovery had been spreading to the corporate sector. One member pointed out that, in the United States, an improving trend had been seen in exports and production since before the presidential election. A different member expressed the view that expectations for economic measures to be taken by the new administration had been reflected in, for example, the recent improvement in firms' and households' sentiment. 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, under accommodative financial conditions.

Members shared the recognition that the European economy maintained its moderate recovery as private consumption continued to increase, although exports had shown some weakness. As for the outlook, they concurred that the economy would likely continue to see a moderate recovery, led by the household sector, under accommodative financial conditions.

Members agreed that the Chinese economy continued to see stable growth on the whole as private consumption maintained its high growth on the back of the favorable employment and income situation, as well as of policy effects, and as exports -- particularly of IT-related goods -- had picked up. 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. One member said that the automobile-related tax cut, which had been implemented as an economic stimulus measure, would continue from 2017, albeit with a smaller reduction rate, and that its effects warranted attention.

Members shared the recognition that emerging economies as a whole had shown a pick-up, although economic activity in some countries had been subdued. A few members noted that exports, mainly of emerging economies in Asia, of a wide range of items including IT-related goods, as well as materials and related goods, had picked up and that inventory adjustments had progressed. As for the outlook, members concurred that emerging economies were likely to see gradual increases in their growth rates, 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 shared the recognition that it was necessary to pay close attention to the possible effects on the global economy of the economic policy management to be taken by the new administration in the United States, considering that a large part of the economic measures was still unspecified. Some members pointed out that emerging economies had experienced depreciations of their currencies and declines in stock prices recently amid the rise in U.S. long-term interest rates and the appreciation of the U.S. dollar, and commented that attention should be paid to the flow of funds related to emerging economies going forward. Some members noted that such market developments could weigh on the recovery of emerging economies that had a large amount of U.S. dollar-denominated debt; therefore, their effects needed to be examined closely. Meanwhile, one member pointed out that views were divided among economists in the United States on the "high-pressure economy," in which medium- to long-term productivity was expected to recover by raising short-term growth rates through proactive measures to stimulate demand. On this basis, this member expressed the view that it was necessary to keep in mind the possibility that the U.S. economic growth rate would accelerate further from a somewhat long-term perspective. Some members said that, in a situation where firms' supply chains were linked globally, trade policy to be instituted by the new administration in the United States and its possible effects on the global economy warranted attention.

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 shared the recognition that the recovery had taken hold more firmly as exports and industrial production had picked up, in a situation where overseas economies had been growing at a moderate pace, and as an improvement in private consumption had started to become evident. On this basis, they agreed that Japan's economy continued its moderate recovery trend. As for the outlook for the economy, members shared the view that the economy was likely to turn to a moderate expansion as (1) 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, and (2) exports were likely to follow a moderate increasing trend on the back of improvement in overseas economies.

Members concurred that exports had picked up with the effects of the slowdown in emerging economies diminishing. One member pointed out that exports to emerging economies -- which had been sluggish -- were recovering, especially for IT-related goods. A different member noted that the PMI for manufacturing activity had clearly improved globally, and that the December 2016 *Tankan* showed that business sentiment had improved at export industries, such as motor vehicles, general-purpose machinery, and production machinery. Members shared the view that exports were likely to continue picking up as a trend as the growth rates of overseas economies were likely to rise moderately, although a decline following the increase in IT-related demand was anticipated in the immediate future.

Members concurred that business fixed investment had been on a moderate increasing trend as corporate profits had been at high levels and business sentiment had improved somewhat. They shared the view that such investment as a whole was likely to continue to see a moderate uptrend, mainly on the back of corporate profits at high levels, although the effects of the earlier slowdown in overseas economies and the yen appreciation were likely to continue to be seen in manufacturing firms. One member expressed the recognition that the December 2016 *Tankan* (1) confirmed that corporate profits remained at high levels and (2) showed that, reflecting this development, firms had generally maintained their solid investment plans. A different member expressed the recognition that the revised GDP statistics suggested that firms' willingness to invest in research and development with the aim of producing new products had been firmly maintained at a high level. One member expressed the view that the recent depreciation trend of the yen and uptrend in stock prices would also support the positive momentum in business fixed investment.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to improve steadily and employee income had increased moderately. One member, pointing to an increase in the year-on-year rate of change in nominal wages of part-time employees, expressed the intent to pay close attention to future developments. With regard to the outlook, members shared the view that employee income was likely to continue to increase moderately as labor market conditions kept improving and corporate profits generally remained at high levels. A few members commented that they were paying attention to developments in the spring wage negotiations between workers and management in 2017, and how their effects would spread to private consumption and prices.

With regard to private consumption, members shared the recognition that positive developments had started to be observed recently, and that it had been resilient against the background of steady improvement in the employment and income situation. A few members pointed out that the quarter-on-quarter rate of change in the consumption activity index remained in positive territory and that the diffusion index for current economic conditions in the November 2016 *Economy Watchers Survey* had risen to a level last seen in March 2014, which was before the consumption tax hike. Some members said that the weakness in private consumption observed after the turn of the year had been due to temporary factors such as the negative wealth effects brought about by the decline in stock prices and weather conditions. These members continued that resilience in consumption had been reconfirmed recently as the effects of such factors had dissipated. In the outlook, members shared the view that private consumption was likely to see an increase in its resilience gradually, with steady improvement in the employment and income situation and the positive contribution from the wealth effects stemming from the rise 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 had picked up, reflecting moderate increases in demand both at home and abroad and the progress in inventory adjustments. A few members expressed the recognition that the increase in production toward summer 2016 had been supported in part by temporary factors such as the accelerated production of automobiles to make up for the earlier disruption and the increase in production of electronic parts for smartphones. They continued that, nevertheless, there was no notable decline following such increase and the pace of increase in production had been maintained, particularly for automobiles to advanced economies and IT-related goods to Asian economies. One member expressed the view that inventory adjustments had progressed, and an increase in shipments had tended to lead to a rise in production. As for the outlook, members agreed that industrial production was likely to continue picking up as a trend, although a decline following the increase in IT-related demand was anticipated in the immediate future.

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. One member expressed the view that the effects of the earlier decline in energy prices would dissipate gradually through the end of fiscal 2016. Meanwhile, members shared the recognition that there were some indicators of inflation expectations that had bottomed out or improved somewhat, but such expectations remained in a weakening phase on the whole.

B. Financial Developments

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.

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 conducting monetary policy, members confirmed 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 view that such momentum was being maintained, and that the year-on-year rate of change in the CPI was likely to increase toward 2 percent as the output gap improved and medium- to long-term inflation expectations rose. Some members expressed the recognition that factors that would support the rise in prices going forward had been increasing, such as (1) the upward pressure on wages accompanying the tightening of labor market conditions, (2) the improvement in private consumption, (3) the rise in crude oil prices, and (4) the depreciation of the yen. Some members noted that, if the observed inflation rate rose, this could be expected to positively affect the formation of inflation expectations through the adaptive formation mechanism. On this basis, one of these members added that, since firms had not been sufficiently proactive in terms of setting higher prices, it was necessary to continue to pay close attention to future developments in their price-setting stance. Meanwhile, a different member expressed the view that the recent yen depreciation might push up prices in the short run but would not raise the underlying trend in inflation.

With respect to QQE with Yield Curve Control, many members expressed the recognition that, despite the global rise in long-term interest rates, particularly in the United States, the JGB yield curve had been formed smoothly in a manner consistent with the guideline for market operations, and that QQE with Yield Curve Control had been functioning as intended at the time of its introduction. A few members pointed out that, under the current policy, which controlled short- and long- term interest rates, improvement in economic conditions amplified monetary easing effects, thereby further strengthening the momentum toward achieving the 2 percent price stability target. One member expressed the view that, compared with the previous policy framework, which specified the amount of JGB purchases as the operating target, the effects of monetary easing were clearer to people under the current framework, which directly specified the most appropriate level of interest rates. A different member expressed the view that the effects of the inflation-overshooting commitment would strengthen gradually, given that people would clearly recognize such effects as the inflation rate rose. On this basis, many members expressed the recognition that, as there was still a long way to go to achieve the price stability target of 2 percent, it was important for the Bank to firmly maintain the current policy framework and guideline for market operations and pursue powerful monetary easing, in order to achieve the target at the earliest possible time.

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 maintain the following guideline. First, as for the short-term policy interest rate, it would apply a negative interest rate of minus 0.1 percent to the Policy-Rate Balances in current accounts held by financial institutions at the Bank. Second, as for the long-term interest rate, the Bank would purchase JGBs so that 10-year JGB yields would remain at around 0 percent. 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.

As for the conduct of outright purchases of JGBs, many members shared the recognition that it was important to conduct them so that the entire yield curve would be formed in a manner consistent with the guideline for market operations, taking into account not only the level of interest rates but also the speed and momentum of their changes, as well as factors behind them. A few members pointed out that, in financial markets, it was believed that the upper and lower limits of the target level of the long-term interest rate, which was set at around 0 percent, were 0.1 percent and minus 0.1 percent, respectively. These members then expressed the recognition that it was inappropriate to set such uniform standards. A different member expressed the recognition that, under the current policy framework, in order for the Policy Board to decide an appropriate guideline for market operations and for the Bank's Market Operations Desk to conduct market operations flexibly in accordance with the guideline while taking into account developments in financial markets, close communication between them was becoming more important than ever.

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, a few members expressed different views. 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 expressed the view that the current guideline for market operations was not appropriate. This member said that the shape of the JGB yield curve that would achieve desirable economic and price conditions should be a little steeper. The member continued that, if it was the case that a rise in market interest rates reflected the prospects for improvement in Japan's economic and price conditions, it was appropriate for the Bank to accommodate such a rise in deciding the guideline for market operations. This member then added that, as the Bank could not fine-tune long-term interest rates, they should be allowed to fluctuate in a larger range, and to the upside in particular.

IV. Remarks by Government Representatives

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

(1) The budget for fiscal 2017 was planned to be decided at the Cabinet meeting to be held on December 22, 2016. Therefore, the government was in the process of finalizing a budget draft, taking into account the Plan to Advance Economic and Fiscal Revitalization, with a view to achieving both economic revitalization and fiscal consolidation. In addition, it planned to formulate the third supplementary budget for fiscal 2016, which would satisfy additional fiscal demands, such as expenses related to disaster relief. The government was working toward a Cabinet decision regarding the third supplementary budget for fiscal 2016 at the same time as one regarding the budget for fiscal 2017.

(2) The ruling parties had compiled an outline on December 8 for the tax reform in fiscal 2017, which incorporated revisions to the following, in view of boosting economic growth in Japan: (1) the tax exemption system for spouses; (2) the research and development tax system to strengthen the competitiveness of the Japanese economy; and (3) the tax system for promoting expansion of income to encourage wage increases. The government would prepare draft tax codes reflecting this outline.

(3) 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. According to the second preliminary GDP estimates for the July-September quarter of 2016, both nominal and real GDP had registered positive growth for the third consecutive quarter on a quarter-on-quarter basis. In the government's economic outlook for fiscal 2017, the real and nominal GDP growth rates were projected to be about 1.5 percent and about 2.5 percent, respectively, and the year-on-year rate of increase in the CPI was expected to be around 1.1 percent. In assessing price developments, it was important to comprehensively examine a wide range of indicators, including the GDP deflator.

(2) At the Council for the Realization of Work Style Reform, the prime minister had asked the industrial sector to (1) conduct wage increases of at least the same extent as those for 2016, (2) implement base pay increases for a fourth consecutive year, (3) discuss

wage increases that took inflation expectations into consideration, and (4) improve transaction terms for subcontractors and other small and medium-sized enterprises (SMEs). Moreover, the government planned to release a draft guideline for providing equal pay for equal work on December 20, 2016. Under the basic principles of fiscal 2017 budget formulation, the government deemed it more necessary than ever to combine fiscal policy that was oriented toward growth not only with structural reforms but also monetary policy in a balanced manner. It also would proceed with steady initiatives to achieve fiscal soundness while aiming to create a more focused budget by, for example, taking the necessary budgetary measures for important policy issues, such as childrearing and caregiving, that would be needed to realize a society in which all citizens were dynamically engaged, as well as research and development that would be key for Japan's growth strategy.

(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.

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.

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. Meanwhile, Mr. T. Sato expressed dissent from the inflation-overshooting commitment regarding an expansion of the monetary base considering that this was neither realistic nor effective.

A. Mr. T. Kiuchi's Policy Proposal

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 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.

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).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 31 and November 1, 2016 for release on December 26.

Attachment
December 20, 2016
Bank of Japan

Statement on Monetary Policy

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

   (1) Yield curve control

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

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

   The long-term interest rate:
   The Bank will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain at around zero percent. 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.

2. Japan's economy has continued its moderate recovery trend. Overseas economies have continued to grow at a moderate pace, although emerging economies remain sluggish in part.

In this situation, exports have picked up. On the domestic demand side, business fixed investment has been on a moderate increasing trend as corporate profits have been at high levels and business sentiment has improved somewhat. Against the background of steady improvement in the employment and income situation, private consumption has been resilient, and housing investment has continued its pick-up. In the meantime, public investment has been more or less flat. Reflecting these moderate increases in demand both at home and abroad and the progress in inventory adjustments, industrial production has picked up. Financial conditions are highly accommodative. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) has been slightly negative. Inflation expectations have remained in a weakening phase.

3. With regard to the outlook, Japan's economy is likely to turn to a moderate expansion. Domestic demand is likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, on the back of highly accommodative financial conditions and fiscal spending through the government's large-scale stimulus measures. Exports are expected to follow a moderate increasing trend on the back of an improvement in overseas economies. The year-on-year rate of change in the CPI is likely to be slightly negative or about 0 percent for the time being, due to the effects of the decline in energy prices, and as the output gap improves and medium- to long-term inflation expectations rise, it is expected to increase toward 2 percent. [Note 3]

4. Risks to the outlook include the following: developments in emerging and commodity-exporting economies, particularly China; developments in the U.S. economy and the impact of its monetary policy on global financial markets; the consequences stemming from the United Kingdom's vote to leave the European Union (EU) and their effects; prospects regarding the European debt problem, including the financial sector; and geopolitical risks.

5. The Bank will continue with "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner. The Bank will make policy adjustments as appropriate, taking account of developments in economic activity and prices as well as financial conditions, with a view to maintaining the momentum toward achieving the price stability target. [Note 4]

[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.

[Note 3] Mr. T. Kiuchi proposed, concerning the year-on-year rate of change in the CPI, that it was likely to be slightly negative or about 0 percent for the time being, and would thereafter increase very moderately. 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.

[Note 4] Mr. T. Sato opposed the commitment to expanding the monetary base, considering that this was neither realistic nor effective. Mr. T. Kiuchi proposed that the Bank, with the aim to achieve the price stability target of 2 percent in the medium to long term, continue with asset purchases and a virtually zero short-term interest rate policy as long as each of these policy measures was deemed appropriate. 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. T. Sato, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, and Ms. T. Masai.