Not to be released until 8:50 a.m. Japan Standard Time on Wednesday, December 26, 2018.

December 26, 2018

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 30 and 31, 2018

(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 Tuesday, October 30, 2018, from 2:00 p.m. to 3:10 p.m., and on Wednesday, October 31, from 9:00 a.m. to 12:01 p.m.[1]

Policy Board Members Present

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

Mr. M. Amamiya, Deputy Governor of the Bank of Japan

Mr. M. Wakatabe, Deputy Governor of the Bank of Japan

Mr. Y. Harada

Mr. Y. Funo

Mr. M. Sakurai

Ms. T. Masai

Mr. H. Suzuki

Mr. G. Kataoka

Government Representatives Present

Mr. K. Ueno, State Minister of Finance, Ministry of Finance[2]

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

Mr. R. Tanaka, State Minister of Cabinet Office, Cabinet Office[2]

Mr. A. Nakamura, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. E. Maeda, Executive Director

Mr. S. Uchida, Executive Director (Assistant Governor)

Mr. Y. Ikeda, Executive Director

Mr. T. Kato, 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, 2018 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. K. Ueno and R. Tanaka were present on October 31.

3 Messrs. E. Chatani and A. Nakamura were present on October 30.

Mr. A. Okuno, 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. H. Ichiue, Head of Economic Research Division, Research and Statistics Department

Mr. Y. Nakata, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. Y. Onozawa, Director-General, Secretariat of the Policy Board

Mr. Y. Yamashiro, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

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

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

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

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

A. Market Operations in the Intermeeting Period

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 of which were decided at the previous meeting on September 18 and 19, 2018, the Bank 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.

B. Recent Developments in Financial Markets

In the money market, interest rates on both overnight and term instruments had been generally in negative territory. The uncollateralized overnight call rate had been in the range of around minus 0.04 to minus 0.07 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) had declined to around minus 0.3 percent against the background of an increase in demand for T-Bills by foreign investors, reflecting a decline in short-term yen funding costs mainly through foreign exchange swaps.

The Nikkei 225 Stock Average had risen to the 24,000-25,000 yen level through early October, mainly on the back of the yen's depreciation and expectations for favorable corporate results, but fell thereafter, partly due to a decline in U.S. stock prices and uncertainties over the trade friction between the United States and China, and was moving at around 22,000 yen recently. In the foreign exchange market, the yen had been more or less flat against the U.S. dollar throughout the intermeeting period; it had depreciated through early October, mainly against the background of a widening of the yield differential between Japan and the United States, but appreciated thereafter due to a worldwide decline in stock prices. Meanwhile, the yen had appreciated against the euro, mainly reflecting uncertainties over political developments in Italy.

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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. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

C. Overseas Economic and Financial Developments

Overseas economies continued to grow firmly on the whole, and were likely to continue doing so.

The U.S. economy had been expanding. Exports had been on an increasing trend. Private consumption had been on an uptrend, supported in part by a favorable employment and income situation and consumer sentiment. Meanwhile, business fixed investment had been increasing firmly, mainly on the back of improvements in corporate profits and business sentiment. As for prices, the year-on-year rate of change in the personal consumption expenditure (PCE) deflator for all items had been in the range of 2.0-2.5 percent, and that for all items excluding food and energy had been at around 2 percent. The economy was likely to maintain its expansion, underpinned by expansionary fiscal measures.

The European economy continued to recover, albeit at a somewhat slower pace. Growth in exports had been decelerating. Private consumption had been on an increasing trend, partly supported by a favorable employment and income situation and consumer sentiment, and business fixed investment also had been on such a trend. 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 2 percent, and that for all items excluding energy, food, alcohol, and tobacco had been at around 1 percent. The European economy was likely to continue its recovery. Meanwhile, economic activity in the United Kingdom had been on a moderate recovery trend with a stable inflation rate.

With regard to emerging economies, the Chinese economy continued to see stable growth on the whole. As for prices, the year-on-year rate of change in the consumer price index (CPI) had been in the range of 2.0-2.5 percent. The economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policies in a timely manner, although it was expected to be affected to some extent by the United States having raised tariffs imposed on China. In the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports being on an increasing trend. Economic activity in Russia and Brazil had been recovering moderately, mainly on the back of stable inflation rates. In India, the economy had been recovering moderately, particularly in domestic demand.

With respect to overseas financial markets, stock prices in many economies had declined, including those in the United States, which had been considered to be overvalued to some extent. This decline had started mainly with a rise in U.S. long-term interest rates reflecting solid economic indicators. Meanwhile, currencies in some emerging economies with high vulnerability had been bought back, mainly against the background of the policy responses taken in Turkey and Argentina. In the commodity market, crude oil prices were more or less unchanged throughout the intermeeting period; they had risen amid concern over geopolitical risks in the Middle East but fell thereafter, due mainly to the decline in U.S. stock prices.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economy was expanding moderately, with a virtuous cycle from income to spending operating, and was likely to continue its moderate expansion.

Exports had been on an increasing trend on the back of overseas economies continuing to grow firmly on the whole. Those to advanced economies continued on their increasing trend, and those to emerging economies had picked up for a wide range of items. Exports, mainly of IT-related goods and capital goods, would likely continue their moderate increasing trend for the time being, and were expected to keep doing so thereafter with the growth in overseas economies continuing.

Public investment had been more or less flat, remaining at a relatively high level. As for the outlook, it was likely to stay at such level, mainly underpinned by Olympic Games-related construction and the supplementary budgets.

Business fixed investment continued on an increasing trend, with corporate profits following their improving trend and business sentiment staying at a favorable level. Machinery orders and construction starts in terms of planned expenses for private nonresidential construction -- both of which are leading indicators of business fixed investment -- continued on an increasing trend, albeit with monthly fluctuations. Business fixed investment was likely to continue increasing for the time being, mainly on the back of an improvement in corporate profits, accommodative financial conditions, and moderate improvement in growth expectations. Thereafter, its pace of increase was likely to decelerate gradually as pressure stemming from cyclical adjustments in capital stock heightened.

As for the employment and income situation, supply-demand conditions in the labor market continued to tighten steadily, and the pace of increase in employee income had accelerated recently. The active job openings-to-applicants ratio had been rising at a high level that exceeded the peak marked during the bubble period, and the unemployment rate continued to be at a low level.

Private consumption had been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. The consumption activity index (CAI; real, travel balance adjusted) -- calculated by combining various sales and supply-side statistics -- had increased for the April-June quarter on a quarter-on-quarter basis and also had risen for the July-August period relative to that quarter. Private consumption was expected to follow a moderate increasing trend for the time being, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as by replacement demand for durable goods. Thereafter, private consumption was expected to continue its moderate increasing trend, although it was likely to temporarily turn to a decline due to the scheduled consumption tax hike.

Housing investment had been more or less flat. Looking at housing starts in detail, those for owner-occupied houses, housing for sale, and housing for rent were all more or less unchanged recently.

Industrial production had been on an increasing trend against the background of rises in demand at home and abroad. It likely would continue to increase for the time being on the back of these rises, and thereafter was expected to continue on a moderate increasing trend with overseas economies growing firmly on the whole.

As for prices, the producer price index (PPI) relative to three months earlier -- adjusted for the effects of seasonal changes in electricity rates -- had been rising, reflecting developments in international commodity prices and foreign exchange rates. The year-on-year rate of change in the CPI for all items less fresh food was around 1 percent, and that for all items less fresh food and energy was at around 0.5 percent recently. With regard to the outlook, the year-on-year rate of change in the CPI (all items less fresh food) was likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising.

2. Financial environment

Financial conditions were highly accommodative.

Inflation expectations had been more or less unchanged. Long-term real 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, such as for funds for business fixed investment, had been increasing. 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 been at a relatively high level. Firms' financial positions had been favorable.

The year-on-year rate of increase in the monetary base had been at around 6 percent, and that in the money stock had been at around 3 percent.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments and the October 2018 *Outlook for Economic Activity and Prices*

A. Economic Developments

Regarding global financial markets, members shared the recognition that, in a situation where factors such as uncertainties over the trade friction between the United States and China had been drawing attention, investors' risk aversion had heightened, brought about by the substantial decline in U.S. stock prices in early October, and stock prices in particular continued to show large fluctuations. One member pointed out that, in addition to the prolonged trade friction between the United States and China, such factors as the risk of capital outflows from emerging economies, difficulties surrounding negotiations on the United Kingdom's exit from the European Union (EU), and the heightening of geopolitical risks concerning Saudi Arabia had led to a worsening of risk sentiment in the stock market. However, some members noted that, although stock prices had shown large fluctuations, economic fundamentals both at home and abroad had been favorable, and it was encouraging that markets other than the stock market had been generally stable thus far. One of these members added that the decline in U.S. stock prices could be regarded in part as a correction of excessively high expectations for some IT-related firms, and coupled with this, the fact that the effects of the decline in stock prices had not spread to the foreign exchange market suggested that market participants expected the U.S. economy to remain firm going forward. As for market developments surrounding emerging economies, some members said that, although developments in the depreciation of the Turkish and Argentinian currencies had abated recently, close attention should continue to be paid to whether or not capital outflows would spread to countries other than those with economic vulnerability, amid progress in normalization of monetary policy in countries such as the United States.

With respect to overseas economies, members shared the recognition that they continued to grow firmly on the whole. Many members expressed the view that, although there had been increasing disparities of growth among countries and regions recently, the virtuous cycle of economic activity had been maintained, led by growth in the U.S. economy. Some members noted that due attention needed to be paid to the fact that the pace of improvement in business sentiment had been slowing, as seen in the Global Purchasing Managers' Index (PMI) for manufacturing having been on a declining trend, although it remained at a level above 50 points. One of these members expressed the view that overseas economies were beginning to level off against the background of the trade friction and the rise in U.S. interest rates. As for the outlook, members agreed that overseas economies were likely to maintain their firm growth on the whole. Some members pointed out that, although the projection for global growth in the October 2018 *World Economic Outlook* released by the International Monetary Fund (IMF) had been revised somewhat downward, growth was likely to remain relatively high for the time being, in the range of 3.5-4.0 percent, and that world trade volume was likely to register a year-on-year growth rate of around 4 percent. These members then expressed the recognition that, although uncertainties regarding the outlook for the global economy had been heightening somewhat, the scenario at this point was still one in which the global economy was likely to continue on an expanding trend.

With regard to the current situation of overseas economies by region and their outlook, members concurred that the U.S. economy had been expanding. Some members noted that the U.S. economy continued to see firm growth, as evidenced by the Institute for Supply Management (ISM) indices for nonmanufacturing for September having marked their highest levels in about 20 years, with the real GDP growth rate for the July-September quarter having been at around 3.5 percent on an annualized quarter-on-quarter basis. Based on this, a few members pointed out that due attention needed to be paid to the fact that the housing market had been weakening somewhat recently, due partly to the effects of the rise in interest rates. As for the outlook, members shared the view that the economy was likely to maintain its expansion, underpinned mainly by expansionary fiscal measures. One member said that, since increases had been seen, for example, in covenant-lite loans -- loans with eased financial covenants -- and in the delinquency rates of subprime auto loans, the member was paying close attention to future financial developments. In relation to this, a different member expressed the view that significant financial distortions had not arisen to this point for the following reasons: (1) the price-earnings ratio after adjustment for cyclical factors had exceeded the level at the time of the global financial crisis, but this alone could not be taken as a sign that the market was overheating, and (2) the debt outstanding of households and firms had not accumulated as excessively as it had at the time of the crisis.

Members shared the recognition that the European economy continued to recover, albeit at a somewhat slower pace. Some members expressed the view that business fixed investment and private consumption continued to be on an uptrend, although sluggishness was seen in the recent PMI and export figures. As for the outlook, members concurred that the European economy was likely to continue its recovery. Some members said that heightened uncertainties over negotiations on the United Kingdom's exit from the EU and the fiscal problem in Italy could lead to changes in the trend in financial markets and exert downward pressure on the European economy, and therefore it was necessary to carefully monitor whether the recovery trend in the European economy would be maintained.

Members shared the recognition that emerging economies had been recovering moderately overall. They agreed that the Chinese economy continued to see stable growth on the whole. Members concurred that, in the NIEs and the ASEAN countries, domestic demand had been resilient, as business and household sentiment had improved, with exports having been on an increasing trend. They shared the recognition that commodity-exporting economies had been recovering moderately, mainly on the back of stable inflation rates. As for the outlook, members agreed that emerging economies were likely to continue their moderate recovery overall. Many members shared the view that the Chinese economy was likely to broadly follow a stable growth path as authorities conducted fiscal and monetary policies in a timely manner, although it was likely to be affected to some extent by the United States having raised tariffs imposed on China. On this basis, a few members said that due attention should be paid in particular to the effects on emerging economies of the trade friction and the rise in interest rates, since, compared with advanced economies, the weight of trade in emerging economies was higher and these economies were more dependent on investment from abroad.

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, and financial institutions' lending attitudes, as perceived by both large and small firms, continued to be active.

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 agreed that the economy was expanding moderately, with a virtuous cycle from income to spending operating. Some members noted that domestic demand continued to increase, as firms' strong fixed investment stance was reconfirmed in the September 2018 *Tankan* (Short-Term Economic Survey of Enterprises in Japan). Some members expressed the view that, after registering a high real GDP growth rate of 3.0 percent on an annualized quarter-on-quarter basis for the April-June quarter, real GDP growth was likely to temporarily decelerate for the July-September quarter, mainly due to the effects of natural disasters; however, growth was likely to regain momentum thereafter given the anticipated recovery in production following the natural disasters as well as fiscal spending for reconstruction and restoration.

Regarding recent developments in exports, members shared the recognition that they had been on an increasing trend on the back of overseas economies continuing to grow firmly on the whole, despite the impact of temporary production declines and distribution disruptions due to the natural disasters. As for the outlook, they concurred that exports would likely continue their moderate increasing trend with the growth in overseas economies continuing. One member said that an early recovery in inbound demand in the Kansai region was likely, as Kansai International Airport had resumed normal operations earlier than expected on the back of successful government and private-sector efforts. Meanwhile, a few members commented that some people had pointed to the possibility that the trade friction between the United States and China had been affecting Japan's exports, as growth in orders from China, particularly of machine tools, had been slowing recently. Many members shared the recognition that, although the effects of this problem on Japan's exports seemed to be limited at the moment, due attention needed to be paid to future developments as uncertainties over exports had heightened, with no sign of progress in negotiations between the United States and China.

Members agreed that public investment had been more or less flat, remaining at a relatively high level. They shared the recognition that it was likely to stay at such level, mainly underpinned by Olympic Games-related construction and construction relating to restoration following this summer's natural disasters.

Members concurred that business fixed investment continued on an increasing trend, with corporate profits following their improving trend and business sentiment staying at a favorable level. Some members noted that, according to the September *Tankan*, the rates of increase in business fixed investment plans for fiscal 2018, particularly for large enterprises, evidently had exceeded the past averages for the same time of year, and that firms' fixed investment stance seemed solid, as suggested by interviews with firms after the release of the *Tankan*. Regarding the outlook, members agreed that business fixed investment was likely to continue increasing, mainly on the back of an improvement in corporate profits, accommodative financial conditions, and moderate improvement in growth expectations.

As for the employment and income situation, members shared the recognition that supply-demand conditions in the labor market continued to tighten steadily, and that the pace of increase in employee income had accelerated recently. One member noted that the continued tightening in labor market conditions was evidenced, for example, by the fact that the active job openings-to-applicants ratio had maintained the high level that exceeded the peak marked during the bubble period -- with the ratio for regular employees in particular at a record high level -- while the unemployment rate remained at a low level of around 2.5 percent.

Members shared the recognition that private consumption had been increasing moderately, albeit with fluctuations. In the outlook, they concurred that it was likely to follow a moderate increasing trend, supported by an increase in employee income and the wealth effects stemming from the rise in stock prices, as well as by replacement demand for durable goods. One member pointed out that private consumption had been firm against the backdrop of steady improvement in the employment and income situation, as seen, for example, in the continued increase in the CAI from early spring through summer. A different member noted that, even when taking into consideration the possibility that the data on wage statistics had been overestimated due to replacement of samples, employee income -- wages multiplied by the number of employees -- had been increasing steadily. The member continued that this improvement in income had been underpinning the increase in consumption. Meanwhile, one member expressed the view that, whereas positive developments had been seen in the corporate sector, such as an expansion in business fixed investment, it might take some time for private consumption to be stimulated as there had been no drastic change in households' preference for holding onto their cash and deposits and for saving costs.

Members shared the recognition that housing investment had been more or less flat. They agreed that housing starts -- a leading indicator of housing investment -- for owner-occupied houses, housing for sale, and housing for rent were all more or less unchanged.

Members shared the recognition that industrial production had been on an increasing trend against the background of rises in demand at home and abroad. A few members expressed the view that, although the industrial production index for the July-September quarter had decreased compared with that for the April-June quarter, due to this summer's natural disasters, production facilities and distribution systems in the affected areas had been restored for the most part and the effects of the disasters were likely to be only temporary. Regarding the outlook, members agreed that industrial production would likely continue to increase steadily for the time being on the back of the rises in demand at home and abroad, and thereafter was likely to continue on a moderate increasing trend with overseas economies growing firmly on the whole.

As for prices, members concurred that the year-on-year rate of change in the CPI for all items less fresh food was around 1 percent, and the rate of increase in the CPI for all items less fresh food and energy remained at around 0.5 percent, due partly to firms' cautious wage- and price-setting stance. On this basis, they shared the recognition that, taking account of the recent underlying trend in the CPI, the year-on-year rate of change in the CPI continued to show relatively weak developments compared to the economic expansion and the labor market tightening. Meanwhile, members agreed that inflation expectations had been more or less unchanged. Most members shared the recognition that, although short-term inflation expectations had risen, the situation remained one in which medium- to long-term inflation expectations did not rise easily, mainly because observed prices continued to exhibit relatively weak developments compared primarily to the economic expansion.

B. Outlook for Economic Activity and Prices

In formulating the October 2018 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), with regard to the baseline scenario of the outlook for Japan's economic activity, members shared the view that the economy was likely to continue its moderate expansion. They shared the recognition that, in fiscal 2018, 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, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. Members also agreed that exports were likely to continue their moderate increasing trend on the back of overseas economies growing firmly on the whole. Based on this discussion, they shared the view that Japan's economy was likely to continue growing at a pace above its potential in fiscal 2018. Members shared the recognition that, in fiscal 2019 and 2020, Japan's economy was likely to continue on an expanding trend, partly supported by external demand, although the growth pace was projected to decelerate due to a slowdown in domestic demand. On this basis, they agreed that the projected growth rates were more or less unchanged from those presented in the July 2018 Outlook Report.

Members then discussed Japan's price developments. They shared the recognition that, basically, the continued relatively weak developments in prices compared to the economic expansion and the labor market tightening largely had been affected by the deeply entrenched mindset and behavior -- based on the assumption that wages and prices would not increase easily -- that had resulted mainly from the experience of prolonged low growth and deflation. In addition, members agreed that such factors as the large room to raise productivity, mainly in the nonmanufacturing sector, the technological progress in recent years, and the high wage elasticity of the labor supply among women and seniors had allowed firms to maintain their cautious stance toward raising prices, even amid the economic expansion. One member said that the recent delay in inflation was attributable to the combination of a deflationary mindset based on negative hysteresis -- the phenomenon whereby prolonged stagnant demand brings about a decline in supply capacity -- and factors that exerted downward pressure on prices such as the improvement in productivity over the past few years. The member noted that, therefore, it was clear that the delay was not caused simply by demand shortage.

Following this discussion, members exchanged views regarding the outlook for prices. Most members shared the view that the year-on-year rate of change in the CPI was likely to increase gradually toward 2 percent, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising. These members agreed that the projected rates of increase in the CPI presented in the October 2018 Outlook Report were somewhat lower, mainly for fiscal 2018, than those in the July Outlook Report.

Members then outlined the mechanism through which the year-on-year rate of change in the CPI would increase gradually toward 2 percent, based on the main factors that determine general price inflation. With regard to the output gap, most members agreed that it had widened within positive territory on the back of the steady tightening of labor market conditions and a rise in capital utilization rates. One member added that the inflation mechanism, for which the starting point was a positive output gap, was operating firmly recently, as seen, for example, in the year-on-year rate of change in the CPI having picked up gradually, after hitting bottom for the April-June quarter of 2018, and the diffusion index (DI) for output prices in the *Tankan* remaining within positive territory. As for the outlook, most members shared the view that it was likely that the output gap would continue expanding moderately within positive territory in fiscal 2018, and that, although this expansion would pause, the output gap would remain substantially positive from fiscal 2019 onward. Most members then shared the recognition that medium- to long-term inflation expectations were likely to follow an increasing trend and gradually converge to 2 percent. As background to this, these members pointed to the following: (1) in terms of the adaptive component, a rise in the observed inflation rate accompanying, for example, the improvement in the output gap was likely to push up inflation expectations, 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, which would be effective in pushing up inflation expectations. On this basis, some members expressed the recognition that there had been no change in the direction of prices rising gradually toward 2 percent inflation, although it would still take some time for inflation expectations to rise. One of these members said that it should be assumed that the pace of increase in prices would be moderate, since there were considerable uncertainties regarding changes in people's perception of prices. Meanwhile, a different member said that -- given, for example, that it might have become difficult for the widening of the output gap to push up prices, and that inflation expectations continued to show relatively weak developments -- it could not be judged at present that the inflation rate would increase toward 2 percent.

In addition, with regard to the long-term relationship between the growth potential of Japan's economy and price developments, members concurred that the recent increase in labor participation of women and seniors, as well as firms' efforts toward raising productivity, were likely to weaken upward pressure on wages and prices in the short term, but would possibly strengthen the economy's growth potential and increase upward pressure on wages and prices from a longer-term perspective.

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 four upside and downside risk factors: (1) developments in overseas economies; (2) the effects of the scheduled consumption tax hike; (3) firms' and households' medium- to long-term growth expectations; and (4) fiscal sustainability in the medium to long term. Members shared the recognition that risks regarding overseas economies had become skewed to the downside recently, especially those concerning protectionist moves such as by the United States. Some members said that it was necessary to analyze the effects of the trade friction between the United States and China by taking into account the fact that, in recent years, complex global supply chains had been established and the interdependence among economies had strengthened further. In addition, some members noted that, although the effects of the trade friction on Japan's economy were limited at the moment, attention should be paid not only to the direct impact on Japan's trade activity but also to the possible effects through such indirect channels as the turmoil in global financial markets and the deterioration in business sentiment. One member pointed out that, in terms of stock price developments in Japan, the fall was larger for external demand-oriented firms than for domestic demand-oriented firms. The member then said that market participants therefore could be speculating that the trade friction might also affect Japanese firms to some extent. On the other hand, a few members noted that there had been some developments that would lead to reducing uncertainties, such as an agreement having been reached in the renegotiation of the North American Free Trade Agreement (NAFTA). Moreover, one member commented that one should not be inclined toward being extremely pessimistic regarding the trade friction, given the ongoing dialogue among countries -- including the United States and China -- toward settling the issues. In addition, many members said that the impact of U.S. macroeconomic policies -- including the normalization of monetary policy -- on global financial markets and emerging economies, together with developments in negotiations on the United Kingdoms' exit from the EU and geopolitical risks in regions such as the Middle East, also could be considered risks concerning overseas economies. On this basis, members concurred that, with regard to the outlook for economic activity, risks were skewed to the downside, particularly regarding developments in overseas economies.

As for upside and downside risks to prices, members pointed to the following three factors: (1) developments in medium- to long-term inflation expectations; (2) the responsiveness of prices to the output gap; and (3) developments in foreign exchange rates and international commodity prices. With regard to the first factor, they agreed that, although medium- to long-term inflation expectations were likely to follow an increasing trend, there was a risk that such a rise would lag behind through the adaptive formation mechanism if it took longer than projected for firms' stance to shift toward further raising wages and prices and the observed inflation rate consequently remained relatively sluggish. One member said that, while the baseline scenario was that observed prices would rise with the output gap widening within positive territory and that inflation expectations also would rise through the adaptive formation mechanism, it was a matter of concern that downside risks to overseas economies, whose developments formed the basis for this scenario, had been heightening. Meanwhile, a different member expressed the view that the fact that inflation had been delayed despite the positive output gap was attributable to the inflation mechanism becoming more complex than before -- as seen, for example, in firms' efforts toward improving productivity constraining the rise in prices -- as well as heightening uncertainties going forward. Based on this discussion, members shared the recognition that, regarding the outlook for prices, risks were skewed to the downside, especially concerning 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 conducting monetary policy, most members shared the recognition that, although it was necessary to carefully examine the fact that firms' cautious wage- and price-setting stance and households' cautiousness toward price rises had been persistent, the momentum toward achieving 2 percent inflation was being maintained. As background to this, most members noted that (1) firms' stance was likely to gradually shift toward further raising wages and prices with the output gap remaining positive, and (2) medium- to long-term inflation expectations, which had been more or less unchanged recently, were likely to rise gradually as further price rises came to be observed widely.

Members discussed the measure to strengthen the framework for continuous powerful monetary easing decided at the Monetary Policy Meeting held in July 2018. One member said that, according to surveys of private-sector economists, since the introduction of forward guidance for policy rates, there had been a significant decline in the number of respondents holding the view that the Bank would raise policy rates in the near future. This member then expressed the view that such results indicated that market participants had gained a better understanding of the Bank's policy stance of persistently continuing with the powerful monetary easing. Some members pointed out that the flexible conduct of market operations and asset purchases decided in July generally had been exerting the intended effects, given that indicators for the degree of liquidity and functioning of the JGB market had improved to some extent. One of these members -- noting that JGB yields had moved somewhat since the policy decision in July, mainly in response to developments in economic activity and prices -- expressed the recognition that these movements were within a range in which the effects of powerful monetary easing could be assessed as being ensured. On this basis, the member expressed the view that, as the sustainability of the Bank's policy had been secured by allowing long-term yields to move upward and downward to some extent, the credibility of the Bank's forward guidance had been enhanced, compared with the case when the Bank only made a commitment to simply maintaining a certain level of interest rates without allowing for such flexibility.

Members also discussed <u>the Bank's basic stance on conducting monetary policy</u>. Most members shared the recognition that, although it would take time to achieve the 2 percent price stability target, it was appropriate to persistently continue with the powerful monetary easing under the current guideline for market operations as the momentum toward achieving 2 percent inflation was being maintained. One member noted that, with the aim of achieving the price stability target, the Bank should continue with the current monetary policy stance and persistently encourage the virtuous cycle of the economy to take hold. A different member expressed the recognition that, as the underlying trend in prices continued to show relatively weak developments compared to the economic expansion and the labor market tightening, it was necessary to persistently maintain highly accommodative financial conditions. One member noted that it was important to maintain the positive output gap for as long as possible by continuing with the current monetary easing, and to wait patiently for a rise in prices, while carefully examining any side effects on the financial system. A different member -- noting that there had been times when economic conditions deteriorated after central banks raised their policy rates and long-term interest rates consequently declined -- said that it was important at this point to persistently continue with powerful monetary easing, and that financial institutions also had begun to understand this line of thinking. Meanwhile, one member commented that attention should be paid to the possibility that, if the target level of nominal long-term yields was maintained at around 0 percent for a long time, the positive effects of monetary easing on inflation expectations would instead diminish, depending mainly on developments in real interest rates in the long term. On this basis, the member pointed out that, when conducting yield curve control, it was important to consider in a flexible manner such factors as the range of yield movement and the target maturity of JGBs, while maintaining the framework of monetary easing. On the other hand, one member expressed the recognition that the current situation in which the inflation rate did not seem to be accelerating toward 2 percent should be taken seriously, and that, in this situation, making the range of movement in long-term yields more flexible, as anticipated by some market participants, could be viewed as though the Bank's commitment to achieving 2 percent inflation was compromised. In addition, one member expressed the view that, since it was likely to take longer than expected for the transmission channel of inflation through the adaptive formation mechanism to fully start working, it was especially important to influence inflation expectations directly toward achieving the price stability target at the earliest possible time. On this basis, the member commented that further enhancement of policy coordination with the government, coupled with the strengthening of monetary easing, seemed to be needed.

Members then discussed the risks considered most relevant to the conduct of monetary policy, such as financial imbalances in the long term. They shared the view that there had been no sign so far of excessively bullish expectations in asset markets or in the activities of financial institutions. Nevertheless, members agreed that prolonged downward pressure on financial institutions' profits, with the low interest rate environment and severe competition among financial institutions continuing, could create risks of a gradual pullback in financial intermediation and of destabilizing the financial system. On this basis, they shared the recognition that, although these risks were judged as not significant at this point, mainly because financial institutions had sufficient capital bases, it was necessary to pay close attention to future developments given that developments in financial institutions' profits had a cumulative impact on their financial strength. On these points, one member noted that, since regional financial institutions had increased loans to, for example, middle-risk firms in a situation where lending margins on an expense-adjusted basis had been lower than average credit costs in the past, attention should be paid to the possibility that their profits would decrease at an accelerated pace if the economy moved into a downturn and their credit costs materialized. A few members said that financial institutions' profits had decreased due not only to the low-yield environment, but also due significantly to structural factors, including the decline in population and the number of firms, as well as the subsequent intensification of competition among financial institutions. Given this, these members expressed the recognition that it was important to examine the functioning of financial intermediation in a more comprehensive manner. One member added that, when examining risks concerning the financial system, it was necessary to pay attention to various factors, including structural changes that could not necessarily be fully captured by economic models, such as an expansion of real estate investment trusts in the real estate market. Meanwhile, one member noted that, as a policy tool for addressing the problems of a decline in the functioning of financial intermediation and the accumulation of financial imbalances, the importance of prudential policy that aimed at ensuring the stability of the financial system should not be overlooked, although some held a view that focused on monetary policy measures such as changing the target levels of policy rates. The member continued that, since the functioning of financial intermediation was one of the vital transmission channels of monetary policy, it was indeed necessary to take into account the importance of ensuring its sustainability from the monetary policy front; instead of solely monitoring the profits of financial institutions, it was important to adopt a perspective that focused on making an assessment of the risks of their profitability hindering overall monetary easing effects and exerting an adverse impact on the economy as a whole.

Moreover, one member pointed out that the structural problem of borrowing needs being insufficient for the size of the financial industry should be dealt with by cutting back on jobs that were not profitable, rather than taking excessive risks, and that monetary policy was not the solution to this problem either. On this basis, the member said that, rather, what could be accomplished through monetary policy was a lowering of the adjustment cost in the economy by avoiding deflation through sufficient monetary easing at an early stage and expanding nominal GDP, thereby increasing nominal production of all industries. Meanwhile, one member noted that there were views that monetary policy could not resolve challenges for Japan's economy such as fiscal sustainability and the decline in the potential growth rate. The member expressed the view that, since the introduction of QQE, however, employment and fiscal conditions actually had improved through the economic expansion, and the potential growth rate had been stable.

With respect to yield curve control, members shared the recognition that, since the previous meeting, the JGB yield curve had been formed smoothly in a manner consistent with the guideline for market operations.

Based on the above discussions, regarding the guideline for market operations for the intermeeting period, most 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. While doing so, the yields might move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, it would conduct purchases in a flexible manner so that their amount outstanding would increase at an annual pace of about 80 trillion yen.

On this point, one member expressed the opinion that, since allowing the long-term yields to move to some extent was ambiguous as the guideline for market operations decided by the Policy Board, these yields could rise more than necessary, depending on the Bank's conduct of market operations, which could hamper the intended effects of the current yield curve control. A different member was of the opinion that, taking account of high uncertainties regarding the scheduled consumption tax hike and overseas economies, as well as the low possibility that the output gap would continue to widen within positive territory, it was necessary for yields on JGBs with maturities of 10 years and longer to be broadly lowered further in order to exert a stronger influence on the output gap.

With regard to asset purchases other than JGB purchases, 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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions. 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, most members shared the view that it 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; (3) as for policy rates, maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices, including the effects of the consumption tax hike scheduled to take place in October 2019; and (4) examine the risks considered most relevant to the conduct of monetary policy and 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.

In response, one member noted that the conduct of monetary policy should be data-dependent, not calendar-based. On this basis, the member commented that it was more desirable to introduce forward guidance for policy rates that further clarified its relationship with the price stability target. A different member was of the opinion that, in order to achieve the price stability target at the earliest possible time, it was important to influence inflation expectations directly and that, from this perspective, it was necessary for the Bank to add a commitment that it would take some sort of additional monetary easing measures if the Bank revised downward its assessment of medium- to long-term inflation expectations.

IV. Remarks by Government Representatives

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

(1) The government recently had submitted the supplementary budget for fiscal 2018 to the extraordinary Diet session in order to implement measures such as for the restoration and reconstruction of areas affected by a series of natural disasters and for the installation of air-conditioning units mainly in public elementary and junior high schools. The government would do its utmost to work toward promptly obtaining the Diet's approval of this supplementary budget.

(2) The government was planning to raise the consumption tax rate from the current 8 percent to 10 percent on October 1, 2019, mainly with a view to securing stable financial resources for countermeasures against the declining birthrate and for social security. It would take all possible measures so that the scheduled consumption tax hike would not affect the economy.

(3) The government expected the Bank to continue to work toward achieving the price stability target under QQE with Yield Curve Control, taking account 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 recovering at a moderate pace and was expected to continue doing so. However, attention should be given to the effects on the world economy of developments in the trade friction, the uncertainties regarding overseas economies, and

the effects of volatility in financial markets. Furthermore, sufficient attention should be paid to the economic impacts of the successive natural disasters.

(2) Regarding reforms toward the provision of social security for people across all generations and the realization of the fourth industrial revolution, the government would compile an interim report by the end of the year and decide the action plan by next summer, including a three-year work schedule. To ensure fiscal soundness, the government also would steadily pursue the New Plan to Advance Economic and Fiscal Revitalization.

(3) Building on the experience of the previous consumption tax hike, the government would do its utmost to carry out all possible measures so that the scheduled consumption tax hike in October 2019 would not affect the economy.

(4) The government expected the Bank to steadily pursue monetary easing toward achieving the price stability target, taking account of developments in economic activity and prices as well as financial conditions.

V. Votes

A. Vote 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 zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. With regard to the amount of JGBs to be purchased, the

Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

Votes for the proposal: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki.
Votes against the proposal: Mr. Y. Harada and Mr. G. Kataoka.

Mr. Y. Harada dissented, considering that allowing the long-term yields to move upward and downward to some extent was too ambiguous as the guideline for market operations decided by the Policy Board. Mr. G. Kataoka dissented, considering that, with heightening uncertainties regarding developments in economic activity and prices going forward, it was desirable to strengthen monetary easing so that yields on JGBs with maturities of 10 years and longer would broadly be lowered further.

B. Vote on the Guideline for Asset Purchases

To reflect the 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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank might increase or decrease the amount of purchases depending on market conditions, 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 unanimous vote.

Votes for the proposal: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, Mr. H. Suzuki, and Mr. G. Kataoka.
Votes against the proposal: None.

C. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy. Mr. Y. Harada expressed the opinion that it was appropriate to introduce forward guidance for policy rates that would further clarify its relationship with the price stability target. Mr. G. Kataoka expressed the opinion that further coordination of fiscal and monetary policy was important in order to achieve the price stability target of 2 percent at the earliest possible time, and that it was necessary for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations.

Based on this discussion, 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 2018 Outlook Report (consisting of "The Bank's View" and "The Background") and formed a majority view.

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. It also was confirmed that the full text of the Outlook Report would be made public on November 1. Mr. G. Kataoka opposed the description on the outlook for the CPI, considering that the possibility of the year-on-year rate of change increasing toward 2 percent going forward was low at this point.

Votes for the proposal: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Harada, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki.

Votes against the proposal: Mr. G. Kataoka.

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of September 18 and 19, 2018 for release on November 5.

Attachment

October 31, 2018

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. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices.[6] With regard to the amount of JGBs to be purchased, the Bank will conduct purchases in a flexible manner so that their amount outstanding will increase at an annual pace of about 80 trillion yen.

   (2) Guidelines for asset purchases

   With regard to asset purchases other than JGB purchases, the Bank decided, by a unanimous vote, to set the following guidelines.

   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. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions.

[6] In case of a rapid increase in the yields, the Bank will purchase JGBs promptly and appropriately.

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. 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 consumer price index (CPI, all items less fresh food) exceeds 2 percent and stays above the target in a stable manner. As for policy rates, the Bank intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period of time, taking into account uncertainties regarding economic activity and prices including the effects of the consumption tax hike scheduled to take place in October 2019. It will examine the risks considered most relevant to the conduct of monetary policy and 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 2]

[Note 1] Voting for the action: Mr. H. Kuroda, Mr. M. Amamiya, Mr. M. Wakatabe, Mr. Y. Funo, Mr. M. Sakurai, Ms. T. Masai, and Mr. H. Suzuki. Voting against the action: Mr. Y. Harada and Mr. G. Kataoka. Mr. Y. Harada dissented, considering that allowing the long-term yields to move upward and downward to some extent was too ambiguous as the guideline for market operations decided by the Policy Board. Mr. G. Kataoka dissented, considering that, with heightening uncertainties regarding developments in economic activity and prices going forward, it was desirable to strengthen monetary easing so that yields on JGBs with maturities of 10 years and longer would broadly be lowered further.

[Note 2] Mr. Y. Harada dissented, considering that, as for policy rates, it was appropriate to introduce forward guidance that would further clarify its relationship with the price stability target. In order to achieve the price stability target of 2 percent at the earliest possible time, Mr. G. Kataoka dissented, considering that further coordination of fiscal and monetary policy was important, and that it was necessary for the Bank to make a commitment to taking additional easing measures if it revised downward its assessment of medium- to long-term inflation expectations.