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January 28, 2019

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 19 and 20, 2018

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

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A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Wednesday, December 19, 2018, from 2:00 p.m. to 3:23 p.m., and on Thursday, December 20, from 9:00 a.m. to 11:45 a.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 January 22 and 23, 2019 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 December 20.

[3] Messrs. E. Chatani and A. Nakamura were present on December 19.

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. H. Inaba, 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 October 30 and 31, 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 0.06 to minus 0.07 percent. As for interest rates on term instruments, yields on three-month treasury discount bills (T-Bills) temporarily had been at a low level of around minus 0.3 percent, but had risen somewhat from late November, due partly to a decline in demand for T-Bills by foreign investors against the backdrop of an increase in short-term yen funding costs mainly through foreign exchange swaps.

The Nikkei 225 Stock Average had been showing large fluctuations, partly due to a decline in U.S. stock prices and uncertainties over the U.S.-China trade friction, and was moving at around 21,000 yen recently. The foreign exchange market had been relatively stable, and the yen had been more or less flat against both the U.S. dollar and the euro since the previous meeting.

C. Overseas Economic and Financial Developments

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

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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.

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, both the year-on-year rate of change in the personal consumption expenditure (PCE) deflator for all items 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 had been on a recovery trend, albeit at a slower pace. Growth in exports had been decelerating. Private consumption had generally 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 on its recovery trend. 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 having been 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, investors' risk aversion had heightened mainly against the backdrop of uncertainties over the U.S.-China trade friction as well as the political situation in Europe; in this situation, U.S. and European long-term interest rates had declined and stock markets in many economies had been showing large fluctuations. Meanwhile, currencies in emerging economies had generally been stable with U.S.

long-term interest rates declining. In the commodity market, crude oil prices had declined significantly against the backdrop of some oil-producing economies increasing their production levels and speculation over an abatement of geopolitical risks in the Middle East.

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 overall. Exports were expected to continue on their moderate increasing trend.

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

Business fixed investment continued on an increasing trend, with corporate profits having been at high levels and business sentiment staying at a favorable level. Looking at the *Financial Statements Statistics of Corporations by Industry, Quarterly*, the ratio of current profits to sales for the July-September quarter of 2018 had declined compared with that for the April-June quarter, partly reflecting the effects of natural disasters, but remained at a high level when fluctuations were smoothed out. 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 high levels of corporate profits and accommodative financial conditions.

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 on an uptrend 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 July-September quarter on a quarter-on-quarter basis and also had risen for October relative to that quarter. Private consumption was expected to follow a moderate increasing trend, due partly to an increase in employee income and the wealth effects stemming from the past rise in stock prices.

Housing investment had been more or less flat overall, as owner-occupied houses and housing for sale had started to increase recently, although the number of housing starts in terms of housing for rent had been on a decreasing trend -- albeit with fluctuations -- mainly reflecting a peaking-out in demand for tax saving.

Industrial production had been on an increasing trend against the background of rises in demand at home and abroad. It was expected to continue increasing for the time being on the back of these rises.

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 for 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 had been increasing, such as for funds for business fixed investment and for those related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been in the range of 2.0-2.5 percent. The year-on-year rate of increase in the amount outstanding of CP and corporate bonds had been accelerating. 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 in the range of 2.0-2.5 percent.

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

A. Economic Developments

Regarding global financial markets, members shared the recognition that, mainly against the backdrop of uncertainties over the U.S.-China trade friction and the political situation in Europe, as well as of the decline in crude oil prices, U.S. and European long-term interest rates had declined and stock markets in many economies had been showing large fluctuations. A few members pointed out that the fundamentals of the global economy had not changed substantially, and expressed the view that stock markets might have been reacting somewhat sensitively recently to uncertainties regarding the outlook. Some members, however, said that careful monitoring was required, since recent developments in stock markets might have been suggesting a potential economic downturn or some distortion in the markets, and since there was a possibility of falling into a vicious cycle in which market fluctuations led to further deterioration in sentiment. Meanwhile, some members pointed out that the foreign exchange market, including the value of the yen against the U.S. dollar, had been relatively stable. As reasons for this, some members expressed the opinion that this might have been affected partly by the view that the U.S. economy was likely to remain firm and by the stable yield differential between Japan and the United States, as well as by the significant increase in currency-unhedged foreign direct investment. A few members said that currencies in emerging economies had been more or less flat recently; however, it was necessary to remain vigilant about the risk of capital outflows associated, for example, with the rise in U.S. interest rates. A few members pointed out that the recent decline in crude oil prices was partly affected by demand-side factors such as concern about deceleration of the Chinese economy in addition to a supply-side factor of an increase in production levels by some oil-producing economies.

With respect to overseas economies, members shared the recognition that they continued to grow firmly on the whole. Many members said that, in many economies, business and consumer sentiment had been steady, and positive momentum in domestic demand had been maintained. One member expressed the view that, although an ideal situation of so-called synchronous growth of the global economy was no longer observed, the virtuous cycle of economic activity had been maintained overall. In response to this, a few members pointed out that disparities in growth among countries and regions were becoming clearer, and some of them were starting to show signs of deceleration. As for the outlook, members shared the view that overseas economies were likely to maintain their firm growth on the whole. Some members expressed the recognition that, in a situation where the U.S. economy -- the growth engine of the global economy -- was likely to continue to see relatively high growth, the scenario was still one in which overseas economies as a whole were likely to continue on an expanding trend. Members then shared the recognition that uncertainties regarding overseas economies had heightened further including (1) protectionist moves such as the U.S.-China trade friction, (2) developments in emerging economies including China, and (3) negotiations on the United Kingdom's exit from the European Union (EU). With regard to the U.S.-China trade friction, many members expressed the view that, although there had been some progress in negotiations at the U.S.-China summit meeting, a variety of issues besides the trade imbalance existed between the two countries, and thus there was a low possibility that only the trade friction would be settled ahead of other issues. On this basis, some members noted that it was necessary to closely monitor whether the effects of the trade friction on firms' mindset and behavior would spread over time. One member pointed out that, if the deceleration and downturn in overseas economies became evident, developments in fiscal and monetary policies in each economy would be important.

With regard to the current situation of overseas economies by region and their outlook, members concurred that the U.S. economy had been expanding. One member pointed out that it continued to see firm growth, as evidenced by the Institute for Supply Management (ISM) indices for both manufacturing and nonmanufacturing for November maintaining their high levels of around 60 percent, 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. A different member said that, with the favorable employment and income situation and the recent decline in crude oil prices having been acting as a tailwind, private consumption continued to be on an uptrend -- as seen, for example, in reportedly favorable Christmas sales. Meanwhile, a few members pointed out that due attention needed to be paid to the fact, among others, that, amid a continued rise in interest rates, the housing market had been weakening recently and some indicators such as those of firms' investment activity had been showing signs of peaking out. As for the outlook, members shared the view that the economy was likely to maintain its expansion, underpinned mainly by expansionary fiscal measures. Some members expressed the recognition that, although the effects of the U.S.-China trade friction and developments in the stock market warranted attention, the U.S. economy was likely to remain firm mainly in private consumption, supported by the favorable employment and income situation. Meanwhile, one member noted that the recent decline in the break-even inflation rate (BEI) -- which was regarded as a proxy indicator of inflation expectations -- was a matter for concern, although it could not be described as suggesting an economic downturn.

Members shared the recognition that the European economy had been on a recovery trend, albeit at a slower pace. A few members expressed the view that production in Germany had been sluggish, due particularly to the effects of the tightening of gas emission regulations on automobiles, but domestic demand such as business fixed investment and private consumption remained more or less firm. As for the outlook, members concurred that the European economy was likely to continue on its recovery trend. Some members said that uncertainties regarding the economic outlook had been heightening -- such as those over somewhat fluid political situations in Germany and France, in addition to the developments in negotiations on the United Kingdom's exit from the EU and the fiscal problem in Italy -- 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 would be affected to some extent by the United States having raised tariffs imposed on China. One member added that the recent pick-up in fixed asset investment in China, partly reflecting the effects of the authorities' economic stimulus measures, was a positive development for the outlook. On the other hand, some members pointed out that attention needed to be paid to the fact that some recent indicators suggested a deceleration in the economy, such as decreases in exports and imports as well as automobile sales, although this factor was hidden behind the trade friction and therefore was somewhat difficult to recognize. One member stated that, amid private firms' increasing default rates, authorities had been requesting that banks increase lending in order to resolve the difficulty in funding of firms. This member continued that, going forward, in examining developments in the Chinese economy, it would be necessary to pay attention to such financial developments.

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 agreed that the economy was expanding moderately, with a virtuous cycle from income to spending operating. Many members expressed the recognition that, although real GDP for the July-September quarter had registered significant negative growth, due mainly to the effects of natural disasters, exports and production had turned upward since October, and the December 2018 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) confirmed favorable business sentiment and steady business fixed investment; thus, the basic assessment of Japan's economy had not changed. Moreover, many members expressed the view that, according to developments in various indicators and interviews with firms, the effects of the U.S.-China trade friction and the global decline in stock prices had been limited so far. One member pointed out that demand both at home and abroad had been at sufficient levels, and that the virtuous cycle in which such levels of demand encouraged the expansion of production capacity had been maintained.

As for the outlook for the economy, members concurred that it was likely to continue its moderate expansion. On a more specific note, they shared the recognition that domestic demand was likely to follow an uptrend, with a virtuous cycle from income to spending being maintained in both the corporate and household sectors, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. One member pointed out that, taking into account the fact that restoration of infrastructure had progressed since summer 2018 in areas affected by successive natural disasters, production and exports would likely continue to recover from the past decline. However, a different member noted the following as matters of concern for the future: (1) the actual condition of restoration-related demand and production stemming from natural disasters could not be viewed as having been strong when distortions in seasonal adjustments were smoothed out, and (2) exports, including those to China, had been weak as a whole. One member said that the outlook for economic activity could not be viewed optimistically since an increasing number of firms held cautious views, mainly against the background of the prolonged U.S.-China trade friction, as seen in the forecast of business conditions in the December 2018 *Tankan*. Based on this discussion, many members pointed out that, since it would take some time for fluctuations stemming from the natural disasters to level off and to confirm the trends in production and exports with hard data, it was necessary to make efforts to monitor future economic developments and assess risk factors by utilizing, for example, information obtained from interviews with firms for the time being. Meanwhile, regarding the effects of the consumption tax hike scheduled to take place in October 2019, one member stated that the negative impact on Japan's economy likely would be limited compared to the previous hike in 2014, due partly to the effects of various measures to be taken by the government. However, some members, including this member, pointed out that it was important to continue to carefully examine future developments since the effects of a tax hike varied depending, for example, on consumer sentiment and the employment and income situation at the time.

Regarding recent developments in exports, members shared the recognition that they had been on an increasing trend in a situation where the impact of temporary production declines and distribution disruptions due to the natural disasters had dissipated and overseas economies continued to grow firmly on the whole. One member noted that a drop in exports for the July-September quarter mostly could be explained by a decrease in the value of exports from western Japan, which had been affected by factors such as the heavy rain. As for the outlook, members concurred that exports likely would continue on their moderate increasing trend on the back of overseas economies growing firmly on the whole. A few members then said that, although exports were likely to maintain their moderate growth for the time being, it was important to continue monitoring them carefully as there were some developments suggesting a slowdown in overseas economies, such as a decrease in machine tool orders from 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 that level, mainly underpinned by Olympic Games-related construction and construction relating to restoration following the natural disasters in summer 2018.

Members concurred that business fixed investment continued on an increasing trend, with corporate profits having been at high levels and business sentiment staying at a favorable level. Some members noted that firms' investment stance remained solid as no notable revision in business fixed investment plans for fiscal 2018 was presented in the December 2018 *Tankan*, although real business fixed investment on a GDP basis for the July-September quarter had decreased for the first time in eight quarters, partly due to the effects of the natural disasters. Regarding the outlook, members agreed that business fixed investment was likely to continue increasing, mainly on the back of high levels of corporate profits and accommodative financial conditions. Some members pointed out that, while a variety of investments were expected to continue increasing -- including those aimed at improving business efficiency and saving labor against the background of labor shortage -- the prolonged U.S.-China trade friction could affect business sentiment. These members added that, therefore, collection and analysis of information obtained from interviews with firms would be particularly important until business fixed investment plans for fiscal 2019 became clear in the March 2019 *Tankan*.

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. Many members noted that labor market conditions remained tight, as 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 while the unemployment rate remained at a low level of around 2.5 percent. On this basis, one member expressed the view that the degree of tightness in labor market conditions could differ by industry and type of job as labor slack was said to remain in the back-office and administrative divisions, where progress in business process engineering was slow relative to that of the field-site division, where labor shortage had been intensifying.

Members shared the recognition that private consumption had been increasing moderately, albeit with fluctuations. As for the outlook, they concurred that it was likely to follow a moderate increasing trend, due partly to an increase in employee income and the wealth effects stemming from the past rise in stock prices. One member pointed out that private consumption, although expanding moderately, continued to show relatively weak developments when comparing its expansion with the increase in disposable income. This member continued that, while moves to increase investment and wages had started to be seen in the corporate sector, a challenge lay in the household sector in that the mechanism of the virtuous cycle from income to consumption expenditure had been operating weakly. On this basis, the member said that attention should be paid to this point in considering the effects of the scheduled consumption tax hike on economic activity and prices.

Members shared the recognition that housing investment had been more or less flat overall, as owner-occupied houses and housing for sale had started to increase recently, although the number of housing starts in terms of housing for rent had been on a decreasing trend -- albeit with fluctuations -- mainly reflecting a peaking-out in demand for tax saving.

Members shared the recognition that industrial production had been on an increasing trend against the background of rises in demand at home and abroad. Regarding the outlook, they agreed that it was likely to continue increasing for the time being on the back of these rises. One member expressed the recognition that, while it was currently a phase for production to recover from the drop during the summer, the key was not only whether it would make a recovery but also whether it would resume the increasing trend it had been on before.

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. One member pointed out that the current sluggishness in prices was not caused simply by a demand shortage as it was affected in a complicated manner by, for example, firms' cautious price-setting stance resulting from the past experience of low growth and deflation, as well as by the constraining effects on inflation accompanying a recent rise in productivity, while a positive output gap had exerted upward pressure on wages and prices.

In terms of 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. One member expressed the recognition that the basic mechanism in which the positive output gap was a driver for moderate inflation had been operating, as seen, for example, in the diffusion index for output prices in the *Tankan* having remained within positive territory not only for large but also small enterprises, with tight labor market conditions continuing. A different member expressed the view that, if firms' room to raise productivity decreased, upward pressure on wages resulting from the positive output gap would be reflected in observed wages, thereby inducing a change in firms' price-setting stance. One member said that, although the year-on-year rate of change in the CPI had been positive on the back of the positive output gap, a change in the uptrend observed over the past few years in crude oil prices -- stemming from the significant decline in these prices since October 2018 -- would be a matter of concern for prices going forward. One member noted that, although it was mentioned in the July 2018 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) that "many of the factors that have been delaying inflation are likely to be resolved gradually," taking account of the fact that the CPI for all items less fresh food and energy had been sluggish thereafter, it likely would still take more time for these factors to be resolved. Meanwhile, one member expressed the view that the inflation rate was unlikely to increase toward 2 percent as there was a low possibility that the output gap would continue to widen within positive territory going forward, and the decline in crude oil prices also would contribute to further delaying the achievement of the price stability target.

Members agreed that inflation expectations had been more or less unchanged. One member was of the view that the continued increase in the observed inflation rate for more than a year had gradually been positively affecting the adaptive formation mechanism of inflation expectations, and noted that, in order for inflation expectations to rise further, it was important that inflation rates remain in positive territory. A few members said that attention was warranted on the possibility of such factors as the recent decline in crude oil prices inducing a decline in observed prices and thereby affecting developments in inflation expectations.

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

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 developments observed since July 2018, when the measure to strengthen the framework for continuous powerful monetary easing was decided. Some members pointed out that, since the Bank's decision at the Monetary Policy Meeting held in July to conduct market operations as well as asset purchases in a more flexible manner, daily movements in JGB prices had been increasing to some extent, as evidenced, for example, by the fact that long-term yields had temporarily risen and then declined significantly to this point. These members, noting that such movements had been consistent with, for example, those of U.S. yields, expressed the recognition that the policy decision in July generally had been producing its intended effects, in terms of enhancing the functioning of the JGB market. With regard to purchases of exchange-traded funds (ETFs), a few members expressed the view that the flexible conduct of these purchases in accordance with market conditions from the summer until the end of 2018 had been in line with the measure's purpose -- that is, to lower the risk premia in the stock market in an appropriate manner. On the recent decline in long-term yields, one member expressed the recognition that, taking into account the objective of the measure introduced in July to strengthen the framework for continuous powerful monetary easing, long-term yields should be allowed to temporarily turn negative. The member continued that it was natural for such yields to move more or less symmetrically from "around zero percent," and that the Bank might face a situation in which it would temporarily increase the amount of JGB purchases in a flexible manner while bearing in mind the approximate amount to be purchased -- that is, an annual pace of increase in the amount outstanding of the Bank's JGB holdings of about 80 trillion yen. A different member pointed out that the recent decline in yields was likely to be due to concerns regarding the outlook for the global economy resulting from factors such as the U.S.-China trade friction. The member continued that, therefore, under these circumstances, if the Bank conducted market operations that would bring back interest rates to their previous levels, this instead would tighten monetary conditions more than at present. Meanwhile, one member expressed the recognition that, although there initially had been some misguided market speculation over the policy decision in July -- namely, that the Bank intended to bring about a rise in long-term yields and reduce the amount of ETF purchases -- such views had gradually dissipated and market participants had been gaining a deeper understanding of the Bank's original intention of the policy measure, owing to the Bank's communication and market operations since then. On this basis, the member said that, whether it might be another rise in long-term interest rates or a reduction in the Bank's ETF purchases that would be observed, the market had accumulated enough experience to react calmly to movements in either direction.

Members also discussed the Bank's basic stance on conducting monetary policy. 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. Some members expressed the recognition that adhering to the Bank's stance of achieving the price stability target of 2 percent was also important in view of its commitment to continuing with the powerful monetary easing. A different member pointed out that, in a situation where there were high uncertainties regarding economic and price developments, it was important to sustain moderate economic expansion while avoiding an accumulation of imbalances, and essential to persistently continue with the powerful monetary easing while carefully examining the positive effects and side effects of the policy. This member added that, while there would be a need to take decisive measures accordingly in the event that downside risks to the economy materialized, carrying out bold policy responses at this stage, with no risks having materialized, warranted attention as this could lead to the accumulation of imbalances. In response, one member pointed out that it was necessary to strengthen monetary easing at this point in order to achieve the price stability target at the earliest possible time in view of the risk arising from prolonged monetary easing. This member also said that further coordination between fiscal and monetary policies was important, as it would be more difficult to overcome deflation completely if the directions of these policies were different.

Members also deliberated over points to take into account in conducting monetary policy in the future. One member noted that there seemed to be some room for revising the current conduct of the JGB purchase operation, taking into consideration (1) the large stock effect of reducing term premia reflecting the cumulative amount of JGBs through purchasing long-term JGBs and (2) the low remaining ratio of newly issued bonds in the JGB market. Furthermore, this member commented that, mainly taking account of the recent developments in deals with unsold bonds in the corporate bond market, it was possible that investors' demand for corporate bonds would increase in case of higher longer-term interest rates. The member continued that, therefore, a possible future option for the conduct of monetary policy was to consider in a flexible manner factors such as the range of yield movement and the target maturity of JGBs. Meanwhile, one member pointed out that, in a situation where the Bank would continue to purchase JGBs for a long period, it also was necessary to monitor whether constraints would arise on financial institutions' collateral management, which would affect their bids for the Bank's short-term operations. One member said that attention needed to be paid to the possibility that the functioning of regional financial institutions -- as a kind of buffer to support economic activity in their respective regional areas at times of economic downturns -- would decline gradually as the current low interest rate environment exerted downward pressure on financial institutions' profits in a cumulative manner. On this basis, the member added that it was necessary to maintain accommodative financial conditions going forward while paying attention to the situation in regional areas. In relation to this, one member noted that, if the Bank tried to normalize monetary policy prematurely before achieving the price stability target, this could adversely affect economic activity through a rise in interest rates, and in turn reduce financial institutions' profits. The member then commented that financial system stability primarily should be ensured through prudential policy.

Moreover, one member expressed the recognition that, in fiscal 2019, the underlying trend in prices would be very difficult to grasp due to various factors such as the effects of the scheduled consumption tax hike and provision of free education, as well as a possible decline in crude oil prices and a reduction in mobile phone-related prices. On this basis, the member expressed the view that, as long as these factors were contained as only temporary shocks, their impact on the underlying trend in prices and monetary policy conduct would be small, since it was developments in the underlying trend that were considered most relevant to the conduct of monetary policy. Nevertheless, some members, including this member, pointed out that, since the so-called adaptive formation mechanism of inflation expectations had operated strongly in Japan, it was important to continue to carefully examine whether temporary price fluctuations would affect developments in inflation expectations. Some members said that it was necessary to thoroughly discuss the outlook for prices and strategy for communication to the public, including the points mentioned above, at the next Monetary Policy Meeting, at which the Outlook Report would be compiled.

With respect to <u>yield curve control</u>, 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 <u>the guideline for market operations for the intermeeting period</u>, 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 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, for example, on the output gap, taking account of factors such as the low possibility that the output gap would continue to widen within positive territory, in a situation where it was less than a year until the scheduled consumption tax hike and uncertainties regarding domestic and overseas economies had heightened.

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 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 commented on the forward guidance for policy rates that, although the guideline itself -- that is, to maintain the current extremely low short- and long-term interest rates -- should be maintained as a matter of course, 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 was in the process of finalizing the budget for fiscal 2019 with expenditure reforms based on the New Plan to Advance Economic and Fiscal Revitalization and the stance of taking temporary special measures to smooth out the economic impacts caused by the scheduled consumption tax hike. In addition, it was formulating the second supplementary budget for fiscal 2018 in order to address urgent issues such as disaster prevention and mitigation, building national resilience, and early effectuation of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

(2) The ruling parties had compiled an outline for the fiscal 2019 tax reform, which incorporated the following, in order to firmly ensure a growth trajectory for the Japanese economy: (1) tax measures to provide merits for automobile and housing

purchases made after the scheduled consumption tax hike with a view to leveling out fluctuations in demand resulting from the hike; (2) revision to the research and development tax system to promote innovation; and (3) revision to the international taxation system and improvement of the tax payment environment, taking account, for example, of globalization and diversification in economic activity. 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, 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 second preliminary estimate of the real GDP growth rate for the July-September quarter of 2018 was minus 0.6 percent on a quarter-on-quarter basis and minus 2.5 percent on an annualized basis. The government deemed that these figures were greatly affected by the temporary factors of private consumption having been pushed down and exports having marked negative growth due to the successive natural disasters, and that therefore there was no change in its assessment that the Japanese economy was recovering at a moderate pace.

(2) In the government's economic outlook, approved by the Cabinet on December 18, the real GDP growth rates for fiscal 2018 and 2019 were projected to be about 0.9 percent and about 1.3 percent, respectively. As for fiscal 2019, while the consumption tax hike was scheduled to take place in October, the economy was expected to recover, particularly in terms of domestic demand, as a virtuous economic cycle continued to progress with improvement in the employment and income situation, supported partly by the effects of the government's policies, such as temporary special measures.

(3) The Basic Principles of Fiscal 2019 Budget Formulation was decided by the Cabinet on December 7. At the Council on Economic and Fiscal Policy held on December 20, with regard to achieving fiscal soundness, the 2018 reform time schedule would be formulated and Minister Motegi would report the countermeasures for the scheduled consumption tax hike. Building on the experience of the previous consumption tax hike by 3 percentage points, the government would do its utmost to carry out all possible measures so that the scheduled hike 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.

VI. 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 following opinions: (1) the possibility of the year-on-year rate of change in the CPI increasing toward 2 percent going forward was low at this point, and (2) 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).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 30 and 31, 2018 for release on December 26.

Attachment
December 20, 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. Japan's economy is expanding moderately, with a virtuous cycle from income to spending operating. Overseas economies have continued to grow firmly on the whole. In this situation, exports have been on an increasing trend. On the domestic demand side, business fixed investment has continued on an increasing trend, with corporate profits having been at high levels and business sentiment staying at a favorable level. Private consumption has been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation. Meanwhile, housing investment has been more or less flat. Public investment also has been more or less flat, remaining at a relatively high level. Reflecting these increases in demand both at home and abroad, industrial production has been on an increasing trend, and labor market conditions have continued to tighten steadily. 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) is around 1 percent. Inflation expectations have been more or less unchanged.

3. With regard to the outlook, Japan's economy is likely to continue its 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, mainly against the background of highly accommodative financial conditions and the underpinnings through government spending. Exports are expected to continue their moderate increasing trend on the back of overseas economies growing firmly on the whole. The year-on-year rate of change in the CPI is 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. [Note 2]

4. Risks to the outlook include the following: the U.S. macroeconomic policies and their impact on global financial markets; the consequences of protectionist moves and their effects; developments in emerging and commodity-exporting economies including the effects of the two aforementioned factors; negotiations on the United Kingdom's exit from the European Union (EU) and their effects; 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. 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 3]

[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. G. Kataoka dissented, considering that the possibility of the year-on-year rate of change in the CPI increasing toward 2 percent going forward was low at this point.

[Note 3] 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.