Not to be released until 8:50 a.m. Japan Standard Time on Friday, October 8, 2010.

October 8, 2010

Bank of Japan

Minutes of the Monetary Policy Meeting

on August 30, 2010

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Monday, August 30, 2010, from 9:00 a.m. to 12:06 p.m.[1]

Policy Board Members Present

Mr. M. Shirakawa, Chairman, Governor of the Bank of Japan

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

Mr. K. G. Nishimura, Deputy Governor of the Bank of Japan

Ms. M. Suda

Mr. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Government Representatives Present

Mr. M. Ikeda, Senior Vice Minister of Finance, Ministry of Finance

Mr. H. Hiraoka, Senior Vice Minister for Economic and Fiscal Policy, Cabinet Office

Reporting Staff

Mr. K. Yamamoto, Executive Director

Mr. H. Nakaso, Executive Director (Assistant Governor)

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

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

Mr. T. Kato, Head of Policy Planning Division, Monetary Affairs Department

Mr. H. Toyama, Director-General, Financial Markets Department

Mr. K. Momma, Director-General, Research and Statistics Department

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on October 4 and 5, 2010 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.

Mr. T. Sekine, Head of Economic Research Division, Research and Statistics Department

Mr. H. Ono, Director-General, International Department

Secretariat of the Monetary Policy Meeting

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

Mr. T. Tachibana, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. A. Okuno, Senior Economist, Monetary Affairs Department

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

I. Remarks on the Purpose of the Unscheduled Monetary Policy Meeting

The chairman first provided the following explanation for calling an unscheduled Monetary Policy Meeting.

(1) Japan's economy showed further signs of a moderate recovery and was likely to be on a recovery trend. The year-on-year rate of decline in the consumer price index (CPI) for all items excluding fresh food had been slowing and was likely to continue to slow. However, uncertainty about the future had recently heightened, especially for the U.S. economy, where a series of recently released economic indicators were weaker than expected, and the foreign exchange and stock markets had been unstable. Such developments warranted attention from the perspective of a possible impact on Japan's economy.

(2) In view of this situation, the chairman decided to call an unscheduled Monetary Policy Meeting, in accordance with Article 17, paragraph 3 of the Bank of Japan Act, to receive the staff's report on recent financial and economic conditions and consider possible responses to recent developments in terms of market operations.

II. Summary of Staff Reports

A. Financial Market Developments at Home and Abroad

With regard to developments in stock markets at home and abroad, U.S. stock prices fell, mainly because a series of recently released economic indicators were weaker than market expectations, and European stock prices also declined following such developments. Japanese stock prices were also falling against the background of this weakness in U.S. and European stock prices and the appreciation of the yen, and the Nikkei 225 Stock Average had recently been below 9,000 yen.

Long-term interest rates in the United States had declined due mainly to increased concerns over deceleration of the U.S. economy. As the result primarily of a flight to quality triggered by the resurgence of the fiscal problem in Ireland, long-term interest rates in Germany and the United Kingdom had declined and yield spreads between government bonds issued by Germany and those issued by some other European countries had been widening. Amid such declines in U.S. and German long-term interest rates, long-term rates in Japan had also been on a declining trend and the benchmark rate temporarily fell below 0.9 percent.

In the foreign exchange markets, the U.S. dollar and the yen generally appreciated while the euro depreciated, against the backdrop of increased risk aversion among global investors. The yen's exchange rate against the dollar had been unstable, and in late August the yen temporarily appreciated to the range of 83-84 yen amid increased concerns over deceleration of the U.S. economy and the decline in U.S. long-term interest rates.

Japan's money market generally remained stable. The uncollateralized overnight call rate had been at around 0.1 percent, which was the targeted level, and yields on treasury discount bills (T-Bills) had decreased somewhat.

B. Overseas Economic Developments

The U.S. economy had been recovering at a moderate pace, but not a few indicators released in the intermeeting period suggested that the pace was decelerating. The real GDP growth rate for the April-June quarter of 2010 was revised downward from the advance estimate due mainly to a slower increase in inventory investment. Production continued to increase, but the employment situation remained severe, as evidenced by the number of initial claims for unemployment insurance being larger than market expectations. In this situation, retail sales decelerated. In the housing market, with the effects of the expiration of the home-buyer tax credits, housing starts and sales were on a declining trend. With such weak economic indicators, market participants were increasingly concerned over the uncertainty about the outlook for the U.S. economy. Attention should be paid to the possibility that a further dampening of market sentiment might lead to weaker-than-expected economic conditions in the United States, which had been facing the problem of balance-sheet adjustments.

As for the European economy, many economic indicators released after the previous Monetary Policy Meeting were generally firm, although the degree of firmness varied by country.

Emerging economies on the whole continued to grow at a relatively rapid pace on the back of the ongoing increase in domestic demand, although exports had been decelerating somewhat due to a slower increase in inventory investment around the world.

C. Economic Developments in Japan

Exports had been increasing, albeit at a slower pace. Private consumption had been generally picking up and had recently been boosted by the extremely hot weather and a last-minute increase in demand for cars ahead of the expiration of the subsidies for purchasers of environmentally friendly cars. However, according to information obtained, for example, from interviews with firms, some observed that sales of luxury goods were sluggish partly due to the weak stock prices. The employment situation had remained severe, but the degree of severity had eased somewhat, as evidenced by the fact that the ratio of job offers to applicants had continued to improve moderately. The first preliminary estimate of real GDP for the April-June quarter showed a quarter-on-quarter growth rate of 0.1 percent, down substantially from the January-March quarter. However, recent developments in industrial production and corporate profits indicated the possibility that the figure would be revised upward in the second preliminary estimate.

On the price front, the year-on-year pace of decline in the CPI (excluding fresh food) accelerated slightly in July, but its slowing trend had basically continued.

The pace of improvement in Japan's economy was likely to slow temporarily from autumn 2010, partly due to the ending of the boost to consumption from the extremely hot weather and the expiration of the subsidies for purchasers of environmentally friendly cars. Moreover, it was necessary to pay attention to the possibility that heightened uncertainty regarding the outlook for overseas economies and the consequent appreciation of the yen could cause Japan's economic activity and prices to be weaker than expected.

III. Summary of Staff Reports on Possible Responses to Recent Developments in Terms of Market Operations

After receiving the staff reports on economic and financial developments, the chairman made the following remarks: (1) uncertainty about the future had heightened more than before, especially for the U.S. economy, and foreign exchange rates and stock prices had recently been unstable; (2) therefore, it might be necessary to pay more attention to the downside risks to the outlook for Japan's economic activity and prices; and (3) one possible monetary policy measure in this situation would be an expansion of the fixed-rate funds-supplying operation against pooled collateral (hereafter the fixed-rate operation), with the aim of encouraging a decline in market interest rates and further enhancing easy monetary conditions. The chairman then requested that the staff explain how the fixed-rate operation could be expanded.

The staff provided the following explanation.

(1) Since the introduction of the fixed-rate operation in December 2009, yields on T-Bills, the TIBOR rates, and the average contracted interest rates on new loans and discounts had been declining. Therefore, the operation could be deemed to have been effective in bringing down longer-term money market rates. In addition, the spread between the highest and lowest accepted bid rates on multiple-rate competitive auctions for the funds-supplying operation against pooled collateral had been narrowing gradually, and this suggested that the increased supply of funds through the fixed-rate operation had contributed to reassuring market participants about their funding.

(2) In order to encourage a decline in market interest rates and further enhance easy monetary conditions, the Bank could introduce a six-month term, in addition to the existing three-month term, in the fixed-rate operation and substantially increase the amount of funds to be provided through the operation. The six-month term operation could encourage a decline in a wider range of interest rates such as those for CP and corporate bonds, in addition to the TIBOR and other money market rates with longer maturities. Such an operation might affect firms' borrowing rates and in turn have positive effects on business confidence.

(3) However, there was a possibility that the introduction of such an operation would leave less room for conducting multiple-rate competitive auctions, and might make it difficult for the Bank to control the overnight call rate. Therefore, in terms of specifics such as the frequency of the operation, the Bank should conduct the operation in a flexible manner, taking full account of market conditions.

(4) Based on the above considerations, if the Bank introduced the fixed-rate operation with a six-month term, it could for the time being conduct the operation once or twice per month, with the amount of loans provided in each operation at approximately 800 billion yen. In such a case, funds provided by the six-month term operation would amount to approximately 10 trillion yen, and together with those provided by the existing three-month term operation, the total amount of loans provided through the fixed-rate operation would be approximately 30 trillion yen.

IV. Summary of Discussions by the Policy Board

A. Discussions on Economic and Financial Developments

Members first discussed overseas economic and financial developments.

Many members expressed the following view: the assessment that the U.S. economy as a whole was recovering at a moderate pace basically was unchanged; however, a series of economic indicators that were weaker than market expectations, particularly those relating to employment and housing, indicated that a deceleration in the pace of economic recovery had become evident. Many members noted that, in this situation, the uncertainty about the future for the U.S. economy had heightened, and the effects of this had been reflected in the recent instability in U.S. stock prices. One member expressed the view that U.S. long-term interest rates had declined significantly since the beginning of August, and this might suggest a decrease in the expected economic growth rate and possible prolongation of the disinflationary trend in the U.S. economy. However, a few members commented that, given the economic growth forecast for 2011 and thereafter, the recent decline in U.S. long-term interest rates could be interpreted as reflecting the market's overly pessimistic view.

As regards Europe, a few members were of the view that the uncertainty about the European financial system had lessened somewhat since the results of the stress test exercise on European financial institutions were made public. Some members said, however, that the concern about sovereign risks had reemerged mainly due to the resurgence of the fiscal problem in Ireland, and developments in fiscal and financial conditions in Europe continued to require due attention.

Many members ascribed the yen's recent appreciating trend to the possibility that heightened uncertainty about the future for the global economy had increasingly made investors around the world risk averse and consequently had boosted their demand for the yen, which was considered a relatively safe currency. One member said that some market participants viewed the narrowing of the interest rate differential between Japan and the United States and the difference in monetary easing stance between the two countries as factors behind the yen's appreciation. In this regard, a different member commented that, although some in the market regarded the Federal Reserve's measure decided on August 10 to purchase Treasury securities as additional monetary easing, the measure aimed to avoid a de facto tightening of monetary conditions and maintain the degree of monetary easing, by reinvesting principal payments from its holdings of non-Treasury securities in Treasury securities. Another member expressed the view that an appreciation of the yen did not necessarily result in only negative effects for Japan's economy in the long run, but attention should be paid to the stock market's tendency to regard it as a significant negative factor.

Members then discussed the state of Japan's economy. They concurred that, according to economic indicators released in the intermeeting period and information obtained, for example, from interviews with firms, the economy showed further signs of a moderate recovery and was likely to be on a recovery trend. Some members added that the pace of economic recovery was likely to slow temporarily in the near future mainly because a waning of policy effects would dampen durable goods consumption. One member expressed the opinion that close examination was necessary to judge whether economic growth would be slightly weaker than expected in the interim assessment, in view of factors such as the recent increase in the number of indicators showing a slowdown in the U.S. economy. As for prices, members agreed that the year-on-year rate of decline in the CPI (excluding fresh food) had been slowing and was likely to continue to slow.

As for risks to the outlook for Japan's economic activity and prices, many members said that, given that uncertainty about the future, especially for the U.S. economy, had heightened and foreign exchange rates and stock prices had recently been unstable, the Bank should pay more attention to the downside risks to the outlook. Some members noted that, depending on developments in the U.S. economy and consequent foreign exchange rate movements, Japan's exports might decelerate by more than expected. Some members were of the opinion that attention should also be paid to the risk that the appreciation of the yen and the weakness in stock prices might cause changes in firms' and consumers' confidence and thereby adversely affect their spending. One member said that, if the continuing appreciation of the yen caused firms to revise down their profit forecasts or accelerate their shifting of production sites abroad, an expansion in business fixed investment and employment might be hindered and consequently a self-sustaining economic recovery might be delayed. A different member expressed the view that the yen's appreciation hit the confidence of small firms harder than large ones, because it was generally difficult for small firms to change their business model or diversify their business, and also because their financial strength was more seriously undermined by the recent financial crisis than that of large firms. Meanwhile, another member remarked on having paid attention for quite some time to downside risks to economic activity and prices through the latter half of fiscal 2010, and did not consider that such risks had just recently started heightening. This member also expressed the view that more time should be taken in examining the possible spillover effects on economic activity and prices of the market instability, together with the effects of factors such as the possibility of the market view having become too pessimistic.

B. Summary of Discussions by the Policy Board on Possible Responses to Recent Developments in Terms of Market Operations

Based on the above discussions, most members said that, given the increasing downside risks to the outlook for Japan's economic activity and prices, it was necessary to further enhance easy monetary conditions to further secure Japan's economic recovery. Some members expressed the view that developments in Japan's economic activity and prices had so far been broadly in line with the Bank's baseline scenario, but it was necessary to take a preemptive measure at this point to (1) prevent adverse effects on business and consumer confidence stemming from instability in financial markets and (2) reduce negative impacts on Japan's economy from a possible materialization of downside risks to the U.S. and European economies.

Most members said that, specifically, it would be appropriate to substantially increase the amount of funds to be provided through the fixed-rate operation and thereby encourage a decline in market interest rates. These members continued that it would be appropriate, in line with the staff's explanation, to introduce a six-month term -- in addition to the existing three-month term -- in the fixed-rate operation and start providing additional funds amounting to approximately 10 trillion yen with a six-month term.

Many members said that such action would encourage a decline in a wide range of longer-term money market rates and facilitate further spreading of the effects of the current powerful monetary easing. One member, on the other hand, expressed the view that introducing such an operation would produce only limited additional easing effects, given the current low level of money market rates. In response to this, some members expressed the opinion that, although the level of interest rates had fallen significantly due to the powerful monetary easing so far, there was still room for a further decline. Some members added that, if the Bank's decision at this meeting clearly presented its stance of further easing monetary conditions, this would have the additional effect of alleviating market participants' and economic entities' anxiety about the outlook for the economy.

Some members noted the possibility that the expansion of the fixed-rate operation might undermine the proper functioning of the market and reduce the Bank's ability to control the overnight call rate. On this point, many members expressed the view that, in order to minimize the negative effects on market functioning and the burden on daily market operations, it would be appropriate for the Bank to conduct the operation once or twice per month, taking full account of market conditions.

One member said that the additional easing measure would be chosen as the most appropriate one in light of the current economic and financial situation, based on a close examination and comparison of its positive and negative effects. This member continued that such a stance on the conduct of monetary policy would be consistent with the Bank's usual way of deciding various policy measures. Some members -- while admitting the importance of carefully monitoring developments in markets such as foreign exchange and stock markets -- said that it was necessary to convey to the market clearly that (1) introduction of the fixed-rate operation with a longer term was not intended to directly address fluctuations in financial markets, and (2) it was based on the judgment that more attention should be paid to the downside risks to the outlook for Japan's economic activity and prices.

C. Discussions on Monetary Policy for the Immediate Future

Regarding the guideline for money market operations until the next meeting to be held on September 6 and 7, 2010, members agreed that it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

V. Remarks by Government Representatives

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

(1) The government welcomed the proposal made at this meeting to expand the fixed-rate operation as a swift response to recent changes in economic and financial developments, to be made in parallel with the new economic stimulus package currently being discussed by the government.

(2) The government expected that the Bank -- bearing in mind that overcoming deflation was a policy objective that both entities shared -- would support the economy from the financial side, for example, with a view to overcoming deflation, by continuing to conduct monetary policy in an appropriate and flexible manner while closely exchanging views with the government.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy faced heightened risks of experiencing negative impacts from the appreciation of the yen and a possible slowdown in overseas economies. The Cabinet, taking account of current economic conditions, would promptly decide basic policy for a new economic stimulus package and compile specific measures as swiftly as possible.

(2) The introduction of a six-month term in the fixed-rate operation proposed at this meeting was a prompt action, and the government considered it important for overcoming deflation swiftly and addressing downside risks to the economy. The government expected the Bank to continue to aim at overcoming deflation swiftly and underpin the economy, by conducting monetary policy in an appropriate and flexible manner while sufficiently exchanging views and working together with the government.

VI. Votes

Based on the above discussions, members agreed that it was appropriate to maintain the current guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at around 0.1 percent.

To reflect this view, the chairman formulated the following proposal and put it to a vote.

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

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

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

2. A public statement will be decided separately.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Ms. M. Suda, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, and Mr. Y. Morimoto.

Votes against the proposal: None.

VII. Discussion on the Public Statement Entitled Enhancement of Easy Monetary Conditions

On the basis of the above discussions, the majority of the members were in favor of the introduction of a six-month term in the fixed-rate operation and a substantial increase in the amount of funds to be provided through the operation, in order to encourage a decline in market interest rates and further enhance easy monetary conditions. Ms. M. Suda, however, dissented from the majority view. Members then discussed the statement Enhancement of Easy Monetary Conditions, which included a description of the majority view and Ms. M. Suda's dissent, 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).

Ms. M. Suda, while holding the view that the Bank should take decisive action when deemed necessary and clearly indicate such a stance, gave the following as reasons for dissenting from the introduction of a six-month term in the fixed-rate operation and a substantial increase in the amount of funds to be provided through the operation. First, recently released economic indicators were broadly in line with the Bank's baseline scenario, and more time should be taken in examining the possible spillover effects on economic activity of the appreciation of the yen and the fall in stock prices, together with the effects of factors such as the duration of such instability, the length of time lag for the spillover, and the possibility of the market view having become too pessimistic. Second, introducing the new measure might be interpreted as a countermeasure to the instability in foreign exchange rates, and might heighten the risk of causing an economic bubble to form in the long run. And third, such action would produce only limited easing effects at the high cost of, for example, a further decline in market functioning, and for the purpose of overcoming deflation, the Bank should focus on its ongoing efforts to support strengthening the foundations for economic growth.

VIII. Timing for Approval of the Minutes of the Monetary Policy Meeting

Taking into account practical constraints, the minutes of this meeting would be approved at and released after the Monetary Policy Meeting to be held on October 4 and 5, 2010.

Attachment

August 30, 2010

Bank of Japan

Enhancement of Easy Monetary Conditions

1. At an unscheduled Monetary Policy Meeting held today, the Policy Board of the Bank of Japan newly introduced a six-month term in the fixed-rate funds-supplying operation against pooled collateral and substantially increased the amount of funds to be provided through the operation. With this, the Bank will encourage a decline in market interest rates and further enhance easy monetary conditions.[2]

2. Japan's economy shows further signs of a moderate recovery, and it is likely to be on a recovery trend. With regard to prices, the year-on-year rate of decline in the CPI (excluding fresh food) has been slowing and is expected to continue to slow. In the meantime, uncertainty about the future, especially for the U.S. economy, has heightened more than before, and the foreign exchange and stock markets have recently been unstable. In these circumstances, the Bank judged it necessary to pay more attention to the downside risks to the outlook for Japan's economic activity and prices.

3. The Policy Board of the Bank of Japan decided, by a unanimous vote,[3] to set the following guideline for money market operations for the intermeeting period:

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[2] In the main text, Ms. M. Suda dissented from the introduction of a six-month term in the fixed-rate funds-supplying operation against pooled collateral and a substantial increase of the amount of funds to be provided through the operation.

[3] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Ms. M. Suda, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, and Mr. Y. Morimoto.
Voting against the action: None.

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

4. The Bank believes that the monetary easing measure, together with the government's efforts, will be effective in further ensuring Japan's economic recovery.

5. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. With such recognition, the Bank has been striving to pursue powerful monetary easing, ensure financial market stability, and support strengthening the foundations for economic growth. The Bank will continue to consistently make its utmost contributions as central bank.