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November 2, 2010

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 4 and 5, 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, October 4, 2010, from 2:00 p.m. to 4:18 p.m., and on Tuesday, October 5, from 8:59 a.m. to 1:33 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. Sakurai, Senior Vice Minister of Finance, Ministry of Finance[2]
Mr. Y. Kinoshita, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. T. Wada, Parliamentary Vice-Minister, Cabinet Office[2]
Mr. K. Umetani, Director-General, Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. K. Yamamoto, Executive Director
Mr. H. Nakaso, Executive Director (Assistant Governor)
Mr. M. Amamiya, Executive Director
Mr. N. Kinoshita, Executive Director

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on October 28, 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.
[2] Messrs. M. Sakurai and T. Wada were present on October 5.
[3] Messrs. Y. Kinoshita and K. Umetani were present on October 4.

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

Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department[4]

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

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. H. Chida, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

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

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

Ms. N. Numoto, Head of Market Operations Division, Financial Markets Department[5]

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[4] Messrs. T. Umemori and H. Chida were present on October 5.

[5] Ms. N. Numoto was present on October 5 from 8:59 a.m. to 9:14 a.m.

I. Summary of Staff Reports on Economic and Financial Developments[6]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on September 6 and 7, 2010 and in consideration of the recent formation of market rates, conducted money market operations in a flexible manner.[7] The uncollateralized overnight call rate had been at around 0.1 percent including the period through end-September (the end of a semiannual book closing period for many Japanese firms).

B. Recent Developments in Financial Markets

Japan's money market remained stable due to the Bank's provision of ample funds. General collateral (GC) repo rates had generally been stable in the range of 0.10-0.15 percent, although rising somewhat temporarily. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been stable in the range of 0.10-0.15 percent, and the TIBOR rates, particularly longer-term ones, had been on a moderate declining trend. Issuance rates on CP had been on a moderate downtrend due in part to the downward pressure on overall money market rates and to the continued favorable supply and demand conditions.

Japanese stock prices, after rising mainly in reflection of the rises in U.S. and European stock prices and of the yen's depreciation in mid-September, had been declining somewhat very recently. With regard to long-term interest rates in Japan, the benchmark rate, which had been moving in the 1.15-1.20 percent range around the time of the previous meeting, gradually fell -- partly due to the decline in overseas long-term interest rates -- and had recently been in the range of 0.9-1.0 percent.

The yen had continued to be on an appreciating trend against the U.S. dollar in a situation where uncertainty about the U.S. economy remained high. Its value had recently been in the range of 83.0-83.5 yen, appreciating once again after depreciating to the 85.5-86.0 yen level in mid-September.

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

[7] The guideline was as follows:

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

C. Overseas Economic and Financial Developments

The world economy had been slowing but continued to recover.

The U.S. economy had continued to recover at a slower but moderate pace. Although the pace was decelerating partly due to the waning effects of fiscal stimulus measures, exports were continuing to increase and business fixed investment was rising moderately. In the labor market, the number of employees was picking up but the unemployment rate had been more or less unchanged at a high level, suggesting that the employment situation had not improved noticeably. In these circumstances, private consumption was increasing only gradually, and housing investment remained at a depressed level. In a situation where the economy faced balance-sheet adjustments and it had therefore remained difficult for the self-sustaining virtuous circle of growth in production, income, and spending to operate properly, economic activity still looked unlikely to turn upward and continued to be susceptible to downside risk factors. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less energy and food, or the core CPI, had been moderating partly due to slack in supply and demand conditions and slower growth in wages.

Economic activity in the euro area as a whole was recovering moderately, with some differences in growth by country. Exports and production had continued to increase, although the pace was slowing, and domestic demand components such as private consumption had been rising gradually. As for prices, although the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food had been accelerating somewhat, partly due to a rise in the value-added tax rate in some countries, slack in supply and demand conditions and slower growth in wages continued to exert downward pressure on prices. U.K. economic conditions were recovering at a moderate pace.

The Chinese economy continued to show relatively high growth, although the pace had slowed somewhat. The pace of increase in exports was slowing due to deceleration in overseas economies. Meanwhile, growth in private consumption had been firm due to households' higher income levels. Fixed asset investment had continued to show high growth, although the rate was decelerating partly due to the government's measures to restrain the increase in real estate transactions. Economic conditions in the NIEs and the ASEAN countries had continued to recover as a whole, given that private consumption and business fixed investment had been on an increasing trend while growth in exports and production had slowed. The Indian economy had also continued to grow at a relatively rapid pace. In many of these Asian economies, upward pressure on prices had been increasing due to higher food prices and greater utilization of production factors.

As for global financial markets, U.S. and European stock prices had risen against the background that pessimistic views within the market over the U.S. economy had somewhat subsided. Long-term interest rates in the United States had fallen, mainly reflecting heightened expectations for additional monetary easing, and those in Europe had fallen somewhat in response to the weakening of some economic indicators. Meanwhile, financial developments in some peripheral European countries had been volatile, as evidenced by the yield spreads of government bonds issued by some countries over those issued by Germany; specifically, the yield spreads remained at a high level in Greece and expanded in Ireland and Portugal.

D. Economic and Financial Developments in Japan

1. Economic developments

Growth in exports had recently been decelerating. They were expected to continue increasing, albeit moderately for the time being, reflecting continued improvement in overseas economic conditions.

Public investment was declining, and this trend was likely to continue.

With regard to domestic private demand, corporate profits and business sentiment had been improving, and business fixed investment was showing signs of picking up. Such signs were expected to gradually become more evident as the improvement in corporate profits continued. However, with firms' persistent sense of excessive capital stock, the pace of improvement in business fixed investment was likely to remain moderate for the time being.

The employment and income situation had remained severe, but the degree of severity had eased somewhat. In these circumstances, private consumption had generally been picking up. It was likely to weaken temporarily mainly due to the ending of the boost from the extremely hot weather and the expiration of subsidies for purchasers of environmentally friendly cars, but was expected to pick up again thereafter.

Housing investment had leveled out. It was expected to gradually head for a recovery, given the recent developments in housing starts.

Growth in production had recently been decelerating. It was expected to increase, after showing temporary weakness primarily in durable consumer goods.

On the price front, commodity prices had generally been more or less flat but most recently had shown some upward movement. The domestic corporate goods price index (CGPI) had been somewhat lower than three months earlier, mainly due to the earlier drop in commodity prices and the appreciation of the yen, amid the persistent slack in supply and demand conditions for products. The CGPI was expected to be somewhat weak for the time being, since the effects of the yen's appreciation to date were likely to remain. The CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline had continued. The year-on-year pace of decline in the CPI was likely to slow as a trend as the aggregate supply and demand balance improved gradually.

2. Financial environment

Financial conditions had continued to show signs of easing. The overnight call rate had remained at an extremely low level, and the declining trend in firms' funding costs had continued. While stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices, such effects were beginning to strengthen in light of improved corporate profits. With regard to credit supply, firms saw financial institutions' lending attitudes as improving. Issuing conditions for CP and corporate bonds had remained favorable. As for credit demand, firms' need to fund working capital and fixed investment had declined, and some firms had reduced the on-hand liquidity that they had accumulated. Against this backdrop, bank lending had declined on a year-on-year basis. The outstanding amount of corporate bonds had exceeded the previous year's level, while that of CP had declined. In these circumstances, firms' financial positions had continued to show signs of improvement as a whole. Meanwhile, the year-on-year rate of change in the money stock had been in the range of 2.5-3.0 percent.

II. Amendment to Guidelines on Eligible Collateral

A. Staff Proposal

The staff proposed that the Bank make necessary amendments, including amendments to its Guidelines on Eligible Collateral and the principal terms and conditions for repo operations and securities lending, in view of the results of the Bank's annual review of appropriate margins reflecting recent developments in financial markets.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the proposal and agreed that the decision should be made public.

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

A. Economic Developments

Members agreed that overseas economies had continued to recover, but the pace of recovery had been slowing. As for the outlook, they shared the view that, although the pace would probably continue to slow for the time being, the recovery trend itself was not likely to be interrupted.

Many members expressed the view that the pace of recovery in advanced economies would probably remain moderate as they faced balance-sheet adjustment pressure. Some members expressed the opinion that while overly pessimistic views regarding the outlook observed since summer 2010, especially for the U.S. economy, had somewhat subsided, uncertainty about the outlook remained high.

Members shared the view that the U.S. economy had continued to recover at a slower but moderate pace. Some members -- referring to the substantial decline in the consumer confidence index and weak housing-related indicators, as well as the high unemployment rate and the prolonged average duration of unemployment -- said that the foundation for an economic recovery remained fragile. A few members noted that the U.S. economy's growth rate could remain low for an extended period, as labor productivity declined mainly due to the deterioration of human capital amid the continued high unemployment rate and the prolonged average duration of unemployment. Regarding the slow pace of recovery amid continued balance-sheet adjustments, a few other members commented that Japan's experience since the 1990s did not seem to have been fully comprehended in the United States and European countries, and that the view regarding the burden of these adjustments had just recently begun to gain a renewed understanding.

Many members expressed the view that economic activity in the euro area as a whole was recovering moderately, with some differences in growth by country. Some members said that, although the overall economy had continued to recover moderately, uncertainty regarding the outlook remained high, given the need to proceed with fiscal consolidation and balance-sheet adjustments at financial institutions.

Many members noted that while emerging economies had continued to grow at a relatively rapid pace, led mainly by domestic demand, growth in exports and production was slowing somewhat. One member commented that future developments warranted careful examination to judge whether it was necessary to review the current scenario that these economies would continue to grow at a relatively rapid pace even in a situation where advanced economies were decelerating.

Many members expressed the view that while the Chinese economy continued to show relatively high growth, the pace of increase in exports and production was somewhat slowing due to the deceleration in overseas economies and the government's measures to restrain the increase in real estate transactions. One member noted that attention should be paid to whether the economy could make a soft landing onto a sustainable growth path through measures by the government to prevent an overheating, such as those to restrain the increase in real estate transactions and in energy consumption. A few members said that growth in production might accelerate again, as evidenced by the rise in China's Purchasing Managers' Index (PMI) for manufacturing activity. With regard to economic conditions in the NIEs and the ASEAN countries, some members noted that domestic demand continued to show high growth, but that growth in exports and production had slowed due to the deceleration in overseas economies and adjustments of IT-related goods. One member commented that while adjustments of IT-related goods were likely to be relatively minimal, as they were progressing more quickly than in the past, careful attention should nevertheless be paid to developments such as those in the upcoming Christmas sales.

Regarding global financial markets, some members expressed the view that market concerns about the outlook for the world economy had subsided somewhat and investors had become less risk averse. Some members, however, said that global financial markets had remained unstable, as evidenced by the fact that the sovereign risk problem had continued to lurk, given the wide yield spreads between government bonds issued by Germany and those issued by some peripheral euro area countries, and that large fluctuations had been seen in foreign exchange markets reflecting speculation regarding the conduct of monetary policy around the world.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. They concurred that, although the economy still showed signs of a moderate recovery, the pace was slowing down partly due to the slowdown in overseas economies and the effects of the yen's appreciation on business sentiment. A few members expressed the opinion that the deceleration of growth in exports and production had been expected but might have deviated somewhat downward from what they had envisaged. Members agreed that the pace of economic improvement was likely to remain slow for some time, due to the ending of the last-minute rise in demand ahead of the expiration of subsidies for purchasers of environmentally friendly cars and the increase in the tobacco tax, as well as the ending of the boost from the extremely hot weather. Some members, referring to the results of the September 2010 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) and other survey results, pointed to the possibility that the deceleration in overseas economies and the appreciation of the yen were undermining business and consumer sentiment. Based on the assumption that the improvement in overseas economic conditions would continue, members expressed the view that Japan's economy, after decelerating for some time, would return to a moderate recovery path, with the continued increase in exports and improvement in corporate profits spilling over to business fixed investment and private consumption. One of these members added that there was considerable uncertainty regarding the timing of when the economy would return to a recovery path.

As for the outlook, many members were of the view that the economic growth rate was likely to be somewhat lower than that presented in the July 2010 interim assessment.

With regard to risks for economic activity, members agreed that there were considerable downside risks to advanced economies, such as the possible consequences of balance-sheet adjustments in the United States and Europe and instability in financial markets. Many members said that the appreciation of the yen might exert downward pressure on Japan's economy by negatively affecting business and consumer sentiment, in addition to depressing growth in exports and corporate profits. Many members thus concurred that it was necessary to continue to pay attention to the downside risks to Japan's economy, in view of factors such as the heightened uncertainty regarding the outlook for overseas economies, especially for the U.S. economy, and the possible negative effects of the appreciation of the yen on business sentiment. However, some members again cited the possibility of faster growth in emerging and commodity-exporting economies as an upside risk. One member said that, given the increase in the weight of emerging economies, it was not appropriate to attach too much importance to cautious views regarding advanced economies when judging risks to overseas economies. This member assessed that upside risks to emerging economies and downside risks to advanced economies were broadly balanced. In response, a different member saw risks to overseas economies as tilted to the downside, explaining that the presence of the U.S. economy, including the effects of financial activity, was extremely significant and that the effects on sentiment around the world were similarly considerable.

Turning to developments in each demand component, many members said that exports had been increasing, although their growth had been decelerating. As for the outlook, members agreed that exports were likely to continue increasing, albeit moderately for the time being, reflecting deceleration in overseas economies.

Members agreed that business fixed investment was showing signs of picking up. Many members pointed to the increase in corporate profits shown in the September *Tankan* and the rise in machinery orders and construction starts in terms of floor area as factors behind this view. However, a few members said that, compared to the degree of recovery in corporate profits, the recovery in business fixed investment lacked strength and firms were likely to maintain their cautious stance on investment. One of these members commented that a possible prolonged appreciation of the yen could lead to firms' investment stance becoming even more cautious.

Many members said that the employment and income situation had remained severe, but the degree of severity had eased somewhat. One member expressed the view that, according to the September *Tankan*, firms still regarded their workforces as excessive and thus the pace of recovery in employment would remain very moderate.

Many members were of the view that private consumption had generally been picking up. As for the outlook, members concurred that it was inevitable that private consumption would temporarily decrease significantly, due to the ending of the boost from the extremely hot weather and the last-minute increase in demand ahead of the expiration of subsidies for purchasers of environmentally friendly cars. One member added that the likely decrease in demand for cars might turn out to be more significant than anticipated, since the last-minute increase in demand ahead of the expiration of subsidies for purchasers of environmentally friendly cars had been larger than expected. A different member noted that it was becoming difficult to accurately grasp the actual trend of consumption due to the effects of temporary factors.

Members agreed that growth in production had been decelerating, based on the actual trend discerned through information obtained, for example, from interviews with corporate managers. As for the outlook, some members said that production was highly likely to see a clear decrease in the October-December quarter, primarily in durable consumer goods, although it was likely to continue to trend upward in the longer term.

Members concurred that the CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the pace had been slowing and this trend was likely to continue. As a risk factor for the outlook for prices, a few members noted that inflation might increase more than expected due to a rise in commodity prices brought about by higher growth rates in emerging economies. On the other hand, many members said that, given the large downside risks to Japan's economy, the possibility that weaker-than-expected economic activity would affect price developments required vigilance. One member raised the possibility of the appreciation of the yen exerting downward pressure on prices as a risk factor unique to price developments. Some members said that firms' and households' medium- to long-term inflation expectations might decline due to the fall in prices, and there was significant uncertainty regarding the degree to which inflation expectations would serve to anchor actual changes in prices. A few members said that attention should be paid to the possibility that inflation rates could be revised downward as a result of the revision of the base year for the CPI, which was expected to take place in summer 2011.

Based on the above discussions on developments in economic activity and prices, members agreed that it had become more likely that the return of Japan's economy to a sustainable growth path with price stability would be delayed compared to what had been projected earlier.

B. Financial Developments

Members shared the view that <u>financial conditions</u> had continued to show signs of easing.

A few members said that the declining trend in firms' funding costs had continued. Members agreed that issuing conditions for CP and corporate bonds had remained favorable, as evidenced, for example, by the expansion in the range of firms, including those rated BBB-, issuing corporate bonds. Many members expressed the view that firms' financial positions had continued to show signs of improvement, as evidenced by the results of the September *Tankan* and surveys conducted on small firms.

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

Based on the above discussions on developments in economic activity and prices, members concurred that it was necessary for the Bank to further enhance monetary easing.

Members shared the view that, in order to enhance monetary easing in a situation where there was little room for a further decline in the overnight call rate, the Bank needed to expand its focus of monetary policy to include new areas with room for additional monetary easing and implement a wide range of policy measures. Many members added that the Bank's new areas of focus should include encouraging a decline in longer-term interest rates and various risk premiums. Some members expressed the view that, by working on risk premiums, the Bank would encourage risk-taking activity within the overall economy, which would in turn increase the economy's productivity and strengthen competitiveness, thereby further enhancing the effects of monetary easing. One member said that working on risk-free interest rates as well as risk premiums would not only reduce borrowers' funding costs as a whole, but also increase the availability of funds. Members raised the following as measures to be implemented by the Bank: a change in the guideline for money market operations; clarification of the policy time horizon; and the purchase of various financial assets. One member said that, in discussing policy actions, the Bank should consider the need to employ a wide range of policy tools while maintaining consistency in its policy thinking and purpose, and to leave room to expand the measures.

Some members said that the Bank's policy measures to encourage a decline in longer-term interest rates and various risk premiums were extraordinary for a central bank.

These members attached significance to the extraordinary nature of the purchase of financial assets to encourage a decline in risk premiums, since losses ultimately incurred on the financial assets purchased could impose burdens on the public, and with these purchases the Bank would involve itself in microeconomic resource allocation. These factors could push the Bank closer to the realm of fiscal policy. One member said that it was important that the Bank conduct monetary policy appropriately while achieving a proper balance between (1) the capability of the central bank to implement measures promptly and (2) the extent to which the central bank should implement measures that would have the character of fiscal policy in a democratic society.

Taking the above discussion into consideration, members discussed the following three points: a change in the guideline for money market operations; clarification of the policy time horizon; and establishment of an asset purchase program.

A. Change in the Guideline for Money Market Operations

Regarding the change in the guideline for money market operations, many members said that downward pressure on the overnight call rate was likely to rise further when more ample funds were provided as a result of further enhanced monetary easing. These members added that in order to generate sufficient effects of monetary easing, it would be appropriate for the uncollateralized overnight call rate to be at around 0 to 0.1 percent, and the Bank should clearly present its stance that it would allow the overnight call rate to deviate somewhat considerably below 0.1 percent. Some members noted that the change in the guideline for money market operations would be useful as a way to more explicitly indicate that the Bank was pursuing a virtually zero interest rate policy. Some members said that if interest rates declined to an excessive degree, the negative effects of that decline would be larger than the monetary easing effects, since the financial intermediary function would be impaired by the lower returns of financial institutions and investors. These members continued that interest rates applied to the complementary deposit facility should be maintained at 0.1 percent, so as to anchor the overnight call rate. One member, referring to the level of the policy interest rates set by major foreign central banks, added that central banks in advanced countries shared the view that policy interest rates should be somewhat higher than literally zero percent in order to maximize monetary easing effects. Based on such discussion, members agreed that the uncollateralized overnight call rate should be at around 0 to 0.1 percent and the interest rates applied to the complementary deposit facility maintained at 0.1 percent.

B. Clarification of the Policy Time Horizon Based on the "Understanding of Medium- to Long-Term Price Stability"

As for clarification of the policy time horizon, members agreed that the Bank should clearly state that it would maintain the virtually zero interest rate policy until it judged that price stability was in sight. They shared the view that the "understanding of medium- to long-term price stability" (hereafter "understanding") would be appropriate as the basis for that judgment. Many members expressed the view that such clarification would produce effects such as encouraging a decline in longer-term interest rates. Some members said that such clarification was expected to elucidate the link between the "understanding" and the future conduct of monetary policy, and enable the Bank to explain its thinking behind the policy conduct more comprehensibly to the public.

Given the experience of the bubble economy in Japan and of the recent global financial crisis, many members were of the view that, in a situation where price developments were the only focus of attention and expectations for continuously low interest rates were growing, the accumulation of financial imbalances could impair the stability in economic activity and prices in the medium to long term. Members agreed that, based on this experience, maintaining the virtually zero interest rate policy should be subject to the condition that an examination of risk factors, including the accumulation of financial imbalances, did not reveal any problems. One member said that attention should be focused on preventing excessive growth in expectations for continuously low interest rates as a result of an overly emphasized policy time horizon.

C. Establishment of an Asset Purchase Program

With regard to the establishment of an asset purchase program, members concurred that purchasing of various financial assets was an effective means to encourage a decline in longer-term interest rates and various risk premiums, and it was appropriate to establish a program on the Bank's balance sheet through which it would conduct such purchasing. Some members expressed the view that the purchasing of various financial assets through the program discussed at this meeting should only be a temporary and extraordinary measure. They continued that, to make this point clear, it was desirable to separate the assets purchased through the program from those purchased through other operations, and to identify such a program on the Bank's balance sheet, analogous to the concept of management accounting. Members shared the view that the fixed-rate funds-supplying operation against pooled collateral introduced in December 2009 should also be conducted through the program, since it served the same purpose -- to encourage a decline in longer-term interest rates.

In considering the purchase of various financial assets through the program, members asked about specifics such as the type of assets that could be subject to purchase, their market size, and their yield or price developments. The chairman then requested that the staff explain the specifics.

The staff provided the following explanation.

(1) Some key issues concerning the purchase of various financial assets through the program were as follows: the extent to which the effects of the purchase would spill over; whether or not the purchase would be conducted fairly; and how it would affect the Bank's financial health.

(2) Considering these issues and practical aspects, assets that would be subject to purchase included long-term government bonds, T-Bills, CP, asset-backed CP (ABCP), and corporate bonds; moreover, exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) could be subject to purchase if the Bank received government authorization pursuant to Article 43 of the Bank of Japan Act.

(3) Expected policy effects from the purchase of these assets could be classified as follows: purchasing of government securities would work on longer-term interest rates; that of ETFs and J-REITs would work on risk premiums; and that of CP and corporate bonds would work on both.

Following the staff's explanation, members discussed the specific design of the program.

As for <u>assets to be purchased</u>, many members agreed that, from the viewpoint of encouraging a decline in longer-term interest rates and risk premiums, it was appropriate to include long-term government bonds, T-Bills, CP, ABCP, corporate bonds, ETFs, and J-REITs. With regard to ETFs and J-REITs, some members said that while the amount of purchase might be small, the Bank's purchase would produce positive effects as a catalyst in promoting more active transactions in their markets and more risk-taking activity in the overall economy. One member expressed the view that since the number of highly rated J-REITs was relatively limited, the purchasing of J-REITs would involve difficult judgment calls in terms of the Bank's direct involvement in the allocation of funds to individual firms and industries, and this warranted attention. Some members said that it would be appropriate to purchase long-term government bonds and corporate bonds with a remaining maturity of about one to two years given that the major financing term used by Japanese firms was three years or less. One member expressed the view that the purchase of government securities aimed at encouraging a decline in longer-term interest rates would be inappropriate in a situation where yields on ten-year government bonds were below 1 percent, because it could pose a greater risk of overheating of the bond market, and excessively low interest rates could in turn deprive financial institutions of profit opportunities and instead hamper the effects of monetary easing.

In terms of the size of asset purchases, one member expressed the opinion that, taking a comprehensive view of the market size of various financial assets and the amount of risks that the Bank would be able to take, it would be appropriate for the Bank to purchase a total of about 3.5 trillion yen of long-term government bonds and T-Bills, about 1 trillion yen of CP, ABCP, and corporate bonds, and, if the Bank received government authorization, about 0.5 trillion yen of ETFs and J-REITs, and to conduct such purchases over a period of around one year. Many other members shared this view.

Members also discussed the treatment of the purchase of long-term government bonds through the asset purchase program. Some members said that, in view of the purpose of the purchase as well as the temporary and extraordinary nature of the measure, it would be appropriate to treat it differently from conventional purchases, which were implemented based on the principle that the outstanding amount of the Bank's holdings of Japanese government bonds (JGBs) be kept below the outstanding amount of banknotes in circulation. These members then expressed the view that, by establishing a program on its balance sheet through which the Bank would make the purchase, the Bank would be able to clearly distinguish and treat the purchase separately from conventional purchases of long-term government bonds, which were conducted in accordance with the long-term trend of increase in banknotes. Some members commented that this was likely to reduce the chance of a possible misconception that the purchase through the program was aimed at facilitating government financing. Meanwhile, one member expressed concern that making an exception to the principle that the outstanding amount of the Bank's holdings of JGBs be kept below the outstanding amount of banknotes in circulation could arouse suspicions in the market that the Bank had taken a step toward engaging in government financing, which in turn could adversely affect long-term interest rates.

Based on the above discussions, members concurred that it would be appropriate for the Bank to change the guideline for money market operations, clarify the policy time horizon based on the "understanding," and establish an asset purchase program. Many members expressed the view that, in order to enhance the policy effects, it would be desirable to introduce these measures as a policy package. With regard to the nature of the policy package, some members pointed out that it had the aspect of "credit easing" in the sense that it would encourage a decline in various risk premiums through the Bank's purchases of risk assets. These members continued that, in terms of quantity, the policy package would achieve a quantitative expansion through the provision of ample funds by making effective use of, for example, the Bank's purchases of assets. These members then expressed the view that, since the policy package encompassed such various policy effects, it would be appropriate to regard it as a "comprehensive monetary easing policy," and other members also shared this view. With regard to the establishment of an asset purchase program, as it was necessary to examine specifics such as terms and conditions of the purchases, the chairman instructed the staff to examine the specifics and report on them at a future Monetary Policy Meeting.

Some members noted that, in addition to the implementation of a comprehensive monetary easing policy, it was necessary to steadily carry out the various measures the Bank had introduced thus far, particularly the fund-provisioning measure to support strengthening the foundations for economic growth, which addressed the problem fundamental to the prolonged weakness of Japan's economy.

Lastly, on <u>the future course of monetary policy</u>, members agreed that it would be appropriate for the Bank to continue to carefully examine the outlook for economic activity and prices, and take policy actions in an appropriate manner as a central bank.

V. Remarks by Government Representatives

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

(1) The situation of the Japanese economy remained difficult, although it had been picking up, underpinned mainly by the effects of overseas demand and of policy measures. The foundation for the economy's steps toward overcoming deflation remained fragile, as seen in the fact that the employment situation remained severe, especially for new graduates and younger people, and many regions were suffering from continued difficulties with regard to employment. Under these circumstances, the Japanese economy faced downside risks, particularly the possibility of further appreciation of the yen and a possible slowdown in overseas economies.

(2) In order to deal with the current severe economic conditions, particularly the ongoing appreciation of the yen, and to ensure the overcoming of deflation as well as secure steps toward economic recovery, the Cabinet decided the "Three-Step Economic Measures for the Realization of the New Growth Strategy" on September 10. Based on this, the government took the first step of making urgent responses to the current situation, and was working on the implementation of economic measures including preparation of the supplementary budget for fiscal 2010 as part of the second step, based on instructions from the Prime Minister on September 27.

(3) The government expected that the Bank -- bearing in mind that overcoming deflation was a policy objective for both entities -- would conduct monetary policy in an appropriate and flexible manner in response to economic and financial developments. The government also expected the Bank to conduct monetary policy in a timely and appropriate manner, as it aimed to closely exchange views with relevant ministries and agencies. It also expected the Bank to appropriately explain to market participants and the public its thinking on the future conduct of monetary policy.

The representative from the Cabinet Office made the following remarks.

(1) The Cabinet decided the "Three-Step Economic Measures for the Realization of the New Growth Strategy" on September 10, to deal with the current severe economic conditions, particularly the ongoing appreciation of the yen, and to ensure the overcoming of deflation as well as secure a path toward self-sustaining recovery, and the government had been taking its first step of making urgent responses. As the

second step, the government was working on the implementation of economic measures including preparation of the supplementary budget for fiscal 2010.

(2) The government welcomed the Bank's comprehensive monetary easing policy proposed at this meeting as a policy that was in line with its own efforts to overcome deflation and achieve a self-sustaining recovery, and as a swift action that was in line with its set of policy measures.

(3) 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

A. Vote on the Guideline for Money Market Operations

Based on the above discussions, members shared the view that it was appropriate to change the Bank's target for the uncollateralized overnight call rate from around 0.1 percent to around 0 to 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, effective immediately from the announcement of the decision.

> The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0 to 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.

B. The Chairman's Policy Proposal and Vote on Temporary Rules Including the Principal Terms and Conditions for Funds-Supplying Operations against Pooled Collateral

To reflect the view of members, the chairman formulated a proposal to maintain, for the time being, the 0.1 percent interest rates applied to (1) the complementary deposit facility, (2) the fixed-rate funds-supplying operation against pooled collateral, and (3) the fund-provisioning measure to support strengthening the foundations for economic growth, and put it to a vote. The Policy Board decided the proposal by a unanimous vote.

VII. Discussion on the Public Statement Entitled Comprehensive Monetary Easing

On the basis of the above discussions, members concurred that it was appropriate to implement a comprehensive monetary easing policy composed of the following three measures: (1) a change in the guideline for money market operations; (2) clarification of the policy time horizon based on the "understanding"; and (3) establishment of an asset purchase program. However, of these measures, Ms. M. Suda dissented from considering government securities as assets to be purchased with regard to the establishment of an asset purchase program. Members then discussed the statement Comprehensive Monetary Easing, which included a description of the policy to be implemented and Ms. 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 1).

Ms. M. Suda gave the following as her main reasons for dissenting from considering government securities as assets to be purchased with regard to the establishment of an asset purchase program. First, taking into account the current situation in the Japanese government securities (JGS) market, purchases of government securities through this program were likely to cause an overheating of and a bubble in the bond market. And second, amid the uncertainty regarding the future course of fiscal consolidation in the medium to long term, making an exception for long-term government bonds to be purchased through the program as not being subject to the "banknote principle" might cause a possible misconception that the purchase through the program was aimed at facilitating government financing, which in turn could adversely affect long-term interest rates.

VIII. Approval of the Minutes of the Monetary Policy Meetings

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of August 30, 2010 and September 6 and 7 for release on October 8, 2010.

Attachment 1

October 5, 2010

Bank of Japan

Comprehensive Monetary Easing

1. At the Monetary Policy Meeting held today, in order to further enhance monetary easing, the Policy Board of the Bank of Japan decided to implement a comprehensive monetary easing policy composed of the following three measures.

   (1) Change in the guideline for money market operations (decided by a unanimous vote[8]).

   The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent,[9] effective immediately (see Attachment 2).

   (2) Clarification of policy time horizon based on the "understanding of medium- to long-term price stability"

   The Bank will maintain the virtually zero interest rate policy until it judges, on the basis of the "understanding of medium- to long-term price stability,"[10] that price stability is in sight, on condition that no problem will be identified in examining risk factors, including the accumulation of financial imbalances.

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[8] 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.

[9] Interest rates applied to the Complementary Deposit Facility, the Fixed-Rate Funds-Supplying Operation against Pooled Collateral, and the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth, will be maintained at 0.1 percent.

[10] On the basis of a year-on-year rate of change in the CPI, each Policy Board member's "understanding" falls in a positive range of 2 percent or lower, and the midpoints of most Policy Board members' "understanding" are around 1 percent.

(3) Establishment of an Asset Purchase Program

The Bank will examine establishing, as a temporary measure, a program on its balance sheet to purchase various financial assets, such as government securities, commercial paper (CP), corporate bonds, exchange-traded funds (ETFs), and Japan real estate investment trusts (J-REITs) and to conduct the fixed-rate funds-supplying operation against the pooled collateral[11] (see Attachment 3). To that end, the Chairman has instructed the staff to examine the specifics of establishing an asset purchase program and report at a future Monetary Policy Meeting.

2. Although Japan's economy still shows signs of a moderate recovery, the pace of recovery is slowing down partly due to the slowdown in overseas economies and the effects of the yen's appreciation on business sentiment. While the economic outlook will be examined in the *Outlook for Economic Activity and Prices* at the next Monetary Policy Meeting, mainly due to the waning effects of demand-boosting policy measures, the pace of economic improvement is likely to slow for some time before returning to the moderate recovery path. Comparing with the outlook presented in the Bank's July interim assessment, the economic growth rate is likely to be somewhat lower than expected. In addition, amid heightened uncertainty about the future, especially for the U.S. economy, attention should still be paid to downside risks to Japan's economy. While the year-on-year decline in the CPI (excluding fresh food) has been slowing, a possibility that weaker-than-expected economic activity will affect price developments requires vigilance. Given those circumstances, it has become more likely that the return of Japan's economy to the sustainable growth path with price stability will be delayed.

3. Based on the above assessment of economic activity and prices, the Bank has judged it necessary to further enhance monetary easing as follows.

First, the Bank makes clear that it is pursuing the virtually zero interest rate policy.

[11] In the main text, in examining the establishment of an asset purchase program, Ms. M. Suda dissented from an inclusion of government securities as assets to be purchased.

Second, the Bank confirms that it will maintain the virtually zero interest rate policy until it judges that price stability is in sight and that the "understanding of medium- to long-term price stability" is the basis for the judgment.

Third, taking into account that there is little room for a further decline in short-term interest rates, the Bank will encourage the decline in longer-term interest rates and various risk premiums to further enhance monetary easing. It is an extraordinary measure for a central bank, particularly the purchase of financial assets to encourage the decline in risk premiums. To be explicit on that point and to extensively influence market interest rates and risk premiums, the Bank judges it necessary to establish a program on its balance sheet through which the Bank will purchase various financial assets, as well as conduct a similarly purposed fixed-rate funds-supplying operation against pooled collateral. The purchase of long-term government bonds through the program will be conducted as a temporary measure, and will serve a different purpose compared with the existing purchases of long-term government bonds. Therefore, the Bank's holdings of long-term government bonds purchased through the program will be treated differently from the long-term government bonds purchased within the ceiling of the amount of banknotes in circulation.

4. The Bank will continue to carefully examine the outlook for economic activity and prices, and take policy actions in an appropriate manner as a central bank.

Attachment 2

October 5, 2010

Bank of Japan

Statement on Monetary Policy

At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote,[12] to set the following guideline for money market operations for the intermeeting period, effective immediately:

> The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

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[12] 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.

Attachment 3

Asset Purchase Program

1. Assets to Be Purchased

As assets to be purchased, the Bank will examine long-term government bonds, treasury discount bills, commercial paper (CP), asset-backed CP (ABCP), corporate bonds, exchange-traded funds (ETFs), and Japan real estate investment trusts (J-REITs).

As a fund provisioning method other than the purchase of assets, the Bank will utilize the fixed-rate funds-supplying operation against pooled collateral.

-- The purchases of the ETFs and J-REITs are conditional on receiving approval pursuant to the Bank of Japan Act.

2. Size of the Program

(1) The Bank will examine the size of the program centering on about 35 trillion yen, which is the sum of assets to be newly purchased -- about 5 trillion yen -- and the size of the fixed-rate funds-supplying operation against pooled collateral -- about 30 trillion yen.

(2) The Bank will examine the new purchase of assets so that, principally, the outstanding balance of the total assets purchased will reach about 5 trillion yen after around one year from the start of the purchase, with about 3.5 trillion yen for long-term government bonds and treasury discount bills and about 1 trillion yen for CP, ABCP, and corporate bonds.

3. Terms and Conditions

(1) The Bank will consider terms and conditions of the purchases from a viewpoint of encouraging the decline in longer-term interest rates and risk premiums.

(2) The Bank will purchase long-term government bonds and corporate bonds with a remaining maturity of about one to two years.