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November 21, 2011

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 27, 2011

(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 Thursday, October 27, 2011, from 9:00 a.m. to 1:26 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
Mr. S. Nakamura
Mr. H. Kamezaki
Mr. R. Miyao
Mr. Y. Morimoto
Ms. S. Shirai
Mr. K. Ishida

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance
Mr. H. Ogushi, Parliamentary Secretary of Cabinet Office, 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. K. Momma, Director-General, Monetary Affairs Department
Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department
Mr. K. Kamiyama, Head of Policy Planning Division, Monetary Affairs Department
Mr. S. Aoki, Director-General, Financial Markets Department
Mr. E. Maeda, 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 November 15 and 16, 2011 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. H. Chida, Head of Policy Infrastructure Division, Monetary Affairs Department

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

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

I. Summary of Staff Reports on Economic and Financial Developments[2]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on October 6 and 7, 2011, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[3] In this situation, the uncollateralized overnight call rate had been in the range of 0.075 to around 0.095 percent.

B. Recent Developments in Financial Markets

Money market rates had been stable amid the Bank's provision of ample funds. General collateral (GC) repo rates had been at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been stable at around 0.1 percent on the whole, although those with longer maturities in particular rose marginally in some instances. Rates on longer-term interbank instruments had been more or less unchanged.

The benchmark long-term interest rate had been at around 1.0 percent. Japanese stock prices rose reflecting a rebound in U.S. and European stock prices, and the Nikkei 225 Stock Average had recently been in the range of 8,500-9,000 yen. In the foreign exchange market, while the interest rate differential between Japan and the United States had widened somewhat, the yen had generally moved within a narrow range against the U.S. dollar as market participants paid heed to yen-buying by Japanese exporters. It had recently been in the range of 76-77 yen to the dollar.

C. Overseas Economic and Financial Developments

The world economy continued to recover, but the pace of recovery was slowing.

The U.S. economy continued to recover, but the pace of recovery remained only moderate. In a situation where balance-sheet adjustments were weighing on it, private consumption continued to improve at only a moderate pace, reflecting a slowdown in the improvement in the employment situation and a deterioration in household sentiment.

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

[3] The guideline was as follows:

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

Housing investment remained at a depressed level with housing prices exhibiting weakness. On the other hand, exports and business fixed investment rose moderately. In this situation, production remained on an increasing trend. As for prices, although slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, factors such as the earlier rise in international commodity prices continued to push up inflation rates.

The level of economic activity in the euro area was more or less unchanged. Growth in exports was sluggish owing to the deceleration in the pace of recovery of the world economy, and private consumption was more or less unchanged. A deterioration in consumer sentiment had also spread to major countries such as Germany due to the worsening of the sovereign debt problems in Europe. Under these circumstances, the rate of increase in production was decelerating. As for prices, slack in supply and demand conditions, as well as the slow growth in wages, continued to exert downward pressure on prices, while there was inflationary pressure from the rise in prices of, for example, processed food. Meanwhile, the level of economic activity in the United Kingdom was also more or less unchanged.

With regard to Asia, the Chinese economy continued to show high growth as a whole. Although the rate of increase in exports was slowing somewhat and that in private consumption was decelerating to some extent, due in part to the effects of the rise in prices, fixed asset investment maintained high growth. The Indian economy also continued to grow at a relatively rapid pace, although its growth rate had decelerated somewhat recently. Economic conditions in the NIEs and the ASEAN countries continued to recover since domestic demand was firm and exports and production were increasing, albeit moderately. In many of these Asian economies, inflationary pressure continued to be strong, reflecting the earlier rise in food and materials prices and the higher wage inflation due to tight labor market conditions.

As for global financial markets, U.S. and European stock prices were rising mainly because risk aversion among investors had moderated somewhat following a comprehensive set of measures by the European Union to address the sovereign debt problems in the region, and because a relatively large number of U.S. economic indicators turned out to be better than expected. With regard to the credit market, yield spreads between corporate bonds and government bonds had narrowed slightly. On the other hand, the yield spreads of government bonds issued by European countries over those issued by Germany remained at elevated levels, partly due to the effects of the downgrading of some government bonds and financial institutions in the region, amid concerns about an adverse feedback loop between the fiscal situation and the financial system. As for the interbank market, interest rates on term instruments had been at high levels, reflecting continued concerns over counterparty risk. Regarding financial markets in emerging economies, stock prices rose and currencies stopped depreciating as capital outflow paused with investors' preference for safe assets easing somewhat.

D. Economic and Financial Developments in Japan

1. Economic developments

Japan's economic activity continued picking up. At the same time, however, improvement in business sentiment seemed to be pausing, mainly due to an adverse effect from a slowdown in overseas economies and the appreciation of the yen.

Public investment had almost stopped declining recently, as seen in the fact that the value of contracted public works -- an indicator of the amount of public works orders -- had increased for two consecutive months.

Exports moved up marginally in July and August on a month-on-month basis, followed by a large increase in September, particularly in those of motor vehicles and related goods. In the July-September quarter, exports registered a substantial increase of 8.7 percent from the previous quarter.

The damage caused by the flooding in Thailand had been spreading to Japanese firms' factories in the country. Although it was difficult to judge at present how this damage would affect Japan's economy, attention should be paid to future developments as it could reduce the consolidated profits of Japanese firms as well as Japan's exports and production in the short term.

With regard to business fixed investment, machinery orders -- a leading indicator of machinery investment -- remained on an increasing trend in the July-August period, as in the April-June quarter.

With regard to private consumption, sales at department stores and chain stores declined somewhat in September from the previous month, due to adverse weather conditions such as typhoons. On the other hand, outlays for travel increased substantially in August, recovering to their pre-quake levels, while the pace of recovery had been sluggish following the quake-induced plunge.

As for prices, international commodity prices had declined. The three-month rate of change in the domestic corporate goods price index (CGPI) showed that it had been somewhat weak, due in part to movements in international commodity prices and the effects of the yen's appreciation. The CGPI was expected to remain somewhat weak for the time being. The year-on-year rate of decline in the corporate services price index (CSPI) for all items excluding international transportation tended to slow, reflecting improvement in corporate activity from a relatively long-term perspective.

2. Financial environment

Financial conditions continued to ease, albeit with weakness still being observed in the financial positions of some firms, mainly small ones.

The overnight call rate remained at an extremely low level and firms' funding costs declined moderately. Issuing conditions for CP and corporate bonds continued to be favorable. With regard to firms' funding conditions, the pace of decline in bank lending tended to be slowing. Firms continued to see financial institutions' lending attitudes as being on an improving trend, and financial institutions also maintained a positive stance on lending. Firms retained their recovered financial positions on the whole, albeit with weakness still being observed at some firms, mainly small ones.

II. Summary of Discussions by the Policy Board on Economic and Financial Developments and the October 2011 *Outlook for Economic Activity and Prices*

A. Economic Developments

Members agreed that, although actions had been initiated to promote financial system stability in Europe, global financial markets continued to come under stress against the backdrop of remaining uncertainty about the implementation of such measures. Many members expressed the view that the sovereign debt problems in Europe -- which were spreading to large-scale economies such as Spain and Italy -- had caused a deterioration in the funding conditions of European financial institutions, and therefore concerns over the European financial system as a whole were intensifying further. Some members noted that risk aversion among global investors persisted and the yen remained susceptible to upward pressure, as it was considered a relatively safe currency. Members shared the view that, in order to fully resolve the sovereign debt problems in Europe, the countries concerned should make steady progress with fiscal consolidation by making adjustments to their revenues and expenditures, and tackle structural reforms that would raise the medium- to long-term growth potential of these economies by, for example, enhancing industrial competitiveness. They also recognized that this would take a long time.

Regarding the economic conditions abroad, members agreed that, although the pace of growth had moderated, particularly in advanced economies, overseas economies as a whole continued to be on a modest recovery trend, led by relatively strong growth in emerging and commodity-exporting economies. As for the outlook, they shared the view that the growth pace of overseas economies, especially that of advanced economies, was likely to remain slow for the time being against a backdrop of continued global financial strains but subsequently pick up led by emerging and commodity-exporting economies.

Members shared the view that the U.S. economy continued to recover, but the pace of recovery remained only moderate against the background of the prolonged adjustment in excessive household debt and the housing market, as well as slow recovery in employment. Many members commented that, while indicators for the corporate sector such as production, corporate profits, and business fixed investment had been firm, there had recently been noticeable developments such as the deterioration in consumer sentiment against the backdrop of strains in financial markets, as well as the decline in housing prices reflecting sluggish demand for housing. As for the outlook, members concurred that the pace of growth in the U.S. economy was likely to remain modest against the background of the limited room for further fiscal and monetary stimulus and the persistent strains from balance-sheet adjustments.

Members shared the view that the euro area economy had shown clear signs of deceleration in growth, as household and business sentiment had deteriorated reflecting growing concerns about financial system stability triggered by the sovereign debt problems. As for the outlook, they shared the view that economic recovery was likely to be restrained in a situation where the adverse feedback loop among the fiscal situation, the financial system, and economic activity operated as financial markets would come under persistent stress stemming from the sovereign debt problems, and therefore European financial institutions would intensify the reduction of their assets and tightening of lending attitudes.

Members agreed that, although the pace of growth in emerging and commodity-exporting economies had moderated somewhat, mainly due to waning real purchasing power caused by inflation, the effects of monetary tightening, and the impact of a decline in exports induced by a slowdown in advanced economies, these economies generally continued to see relatively strong growth as the autonomous positive feedback loop among production, income, and expenditures was basically maintained. They also shared the recognition that inflationary pressure had not been sufficiently contained in many emerging and commodity-exporting economies. As for the outlook, they shared the view that, as a gradual decline in inflationary pressure restored the real purchasing power of households, these economies were likely to achieve relatively strong growth, although many would continue to see a slowdown in growth for the time being. Some members commented that, in a situation where financial markets would come under persistent stress stemming from the sovereign debt problems, due attention should be paid to the possibility that global investors' withdrawal of funds from emerging economies would become widespread as a result of their intensified risk aversion.

Members agreed that Japan's financial conditions continued to ease, as evidenced by the fact that issuing conditions for CP and corporate bonds remained favorable and firms' funding costs had declined moderately. They shared the view that the easing trend in financial conditions would likely continue as the effects of the Bank's significant monetary easing spread further, and this would support momentum toward a self-sustained recovery in domestic private demand. One member, commenting that inflation expectations for the short and medium term had recently declined somewhat, said that attention should be paid to the possibility that this would exert upward pressure on short- and medium-term real interest rates and thereby intensify upward pressure on the yen and downward pressure on stock prices.

Based on the above deliberations on economic and financial conditions abroad, as well as Japan's financial conditions, members discussed the state of Japan's economy. They agreed that economic activity continued picking up as supply-side constraints had been mostly resolved and the economy was shifting to a phase in which it would be particularly constrained by developments on the demand side. They also shared the view that production and exports continued to increase, particularly for firms in the automobile-related sectors that were accelerating their inventory restocking both at home and abroad, although the rate of increase in production and exports moderated after going through the recovery phase immediately following the quake-induced plunge. Some members added that improvement in business sentiment seemed to be pausing, mainly due to an adverse effect from a slowdown in overseas economies and the appreciation of the yen. A few members said that the slowdown in overseas economies had started to have a negative effect on developments in exports of IT-related goods, and that the effects of the yen's appreciation were observed in the sluggish recovery in the number of foreign visitors to Japan. Many members noted that, although it was difficult to judge at present the overall picture of how Japan's economy would be affected by the damage caused by the flooding in Thailand, attention needed to be paid to the risk that this would temporarily reduce the profits, exports, and production of Japanese firms, particularly those in the automobile sector and some segments of the electrical machinery sector, for which Thailand was an important production base.

B. Outlook for Economic Activity and Prices

With regard to the baseline scenario of the outlook for Japan's economic activity, members agreed that growth rates for fiscal 2011 and 2012 were likely to be somewhat lower than the forecasts in the July 2011 interim assessment, reflecting the adverse effects of a slowdown in overseas economies and the appreciation of the yen. They shared the view that, under the condition that financial market shocks with possible significant impacts on economic activity were avoided, Japan's economy was likely to return to a moderate recovery path because the pace of recovery in overseas economies would pick up and because demand related to reconstruction after the earthquake disaster would gradually materialize.

Regarding economic developments in the second half of fiscal 2011, members agreed that a slowdown in overseas economies and the appreciation of the yen would have an adverse effect on the economy, especially on the export and production front, while reconstruction-related demand associated with the restoration of capital stock would gradually materialize in a variety of channels, such as public investment, business fixed investment, housing investment, and demand for durable consumer goods. With regard to economic developments in fiscal 2012, members shared the view that, in addition to the continued support from reconstruction-related demand throughout the fiscal year, as the growth rates of overseas economies gradually picked up, Japan's economy was likely to register a relatively high rate of growth supported by the transmission mechanism by which the strength in exports and production fed through into income and spending. They shared the view that, in fiscal 2013, the economy was likely to grow at a pace above its potential led by robust demand from overseas economies, especially emerging and commodity-exporting economies, although the growth rate was likely to be lower than that in fiscal 2012 because the contribution from reconstruction-related demand would gradually diminish.

Regarding the outlook for the consumer price index (CPI) for all items less fresh food, members agreed that, with an improvement in the aggregate supply and demand balance and stable medium- to long-term inflation expectations, the year-on-year rate of change in the CPI would remain at around 0 percent for the time being but gradually rise to around 0.5 percent toward the latter half of the projection period, which covered fiscal 2011 through fiscal 2013. They shared the view that international commodity prices, which formed the basis for the outlook for the CPI, had recently softened reflecting the global economic slowdown, and that they were likely to increase moderately over the relatively long term led by food and energy prices amid the continued high growth in emerging economies. They concurred that, while their forecasts of the year-on-year rate of change in the CPI (all items less fresh food) were made based on the fixed-weighted CPI, the year-on-year rate of change in the chain-weighted CPI around 2013 might be slightly lower.

Members also discussed upside and downside risk factors to the baseline scenario.

Regarding economic activity, members noted the following upside and downside risk factors: (1) developments in global financial markets, especially those related to the sovereign debt problems in Europe; (2) developments in overseas economies; (3) developments in the demand related to reconstruction after the earthquake disaster; and (4) firms' and households' medium- to long-term growth expectations. Some members said that, in addition to these factors, uncertainty regarding the timing of resumed operations at the nuclear power plants and electric power supply constraints should be borne in mind. One member pointed out that the financial system and financial condition of firms in Japan remained sound compared with those in the United States and Europe, and that this might become an upside risk factor for economic activity in Japan.

Members concurred that there was high uncertainty regarding the possible outcome of the sovereign debt problems in Europe, including its impact on the global economy. They shared the view that, if global investors' risk-averse behavior further intensified in financial and foreign exchange markets, thereby resulting in further appreciation of the yen and a stock price fall, such events could cause Japan's growth outlook to deviate downward partly through a deterioration in business and household sentiment. Some members commented that, if the profitability of exporting firms deteriorated due to a substantial appreciation of the yen, attention needed to be paid in particular to the possibility that corporate profits would be dampened, which consequently would have an adverse effect on the employment and income conditions. One member expressed concern that, in a situation where financial markets continued to come under stress stemming from the sovereign debt problems, if the trend of substantial appreciation of the yen persisted, thereby leading to the shift of Japanese firms' key factories and research and development bases to overseas, this could induce substantial declines in domestic investment and employment.

With regard to overseas economies, members shared the view that due attention needed to be paid to (1) how balance-sheet adjustments would affect the U.S. economy; (2) whether the adverse feedback loop among the fiscal situation, the financial system, and economic activity would intensify in Europe against the backdrop of the sovereign debt problems; and (3) whether price stability and economic growth could be achieved at the same time in emerging and commodity-exporting economies. Many members said that attention should be paid to the risk that, depending on future policy responses to the sovereign debt problems, European financial institutions might further intensify the reduction of their assets or lending cuts.

A few members expressed concern over the risk that firms' and households' growth expectations would decline and the growth outlook for the projection period would worsen as Japan's economy, in the course of recovering from the disaster, faced such negative shocks as a slowdown in overseas economies, the appreciation of the yen, and electric power supply constraints.

Members pointed to the following as upside and downside risk factors to the outlook for prices: (1) possible effects of the materialization of upside or downside risks to economic activity; (2) possible changes in firms' and households' medium- to long-term inflation expectations; and (3) developments in import prices. With regard to the second risk factor, one member said that attention should be paid to the risk that inflation and growth expectations would not rise if the expected timing of an exit from deflation were to be pushed further back, thereby causing the private sector to postpone spending.

Based on the above considerations, members assessed the economic and price situation from two perspectives.

Members made an assessment in terms of the first perspective; that is, they comprehensively assessed the baseline scenario of the outlook for economic activity and prices considered to be the most likely through fiscal 2013. They shared the view that the forecasts of growth rates for fiscal 2011 and 2012 were likely to be somewhat lower than those in the July 2011 interim assessment, and that some more time would be needed to confirm that price stability was in sight for Japan's economy based on the "understanding of medium- to long-term price stability" (hereafter "understanding").

Members then made an assessment in terms of the second perspective; namely, they examined the risks considered most relevant to the conduct of monetary policy, including risks that had a longer time horizon than the first perspective. In terms of economic activity, they shared the view that there was a need to carefully examine how Japan's economy would be affected by the uncertainty regarding developments in overseas economies and ensuing disturbances in financial and foreign exchange markets. Some members commented that, in a situation where global financial markets continued to come under stress stemming from the sovereign debt problems in Europe, it should also be noted that there was a risk that financial market shocks akin to the Lehman shock could hit Japan's economy with possible significant impact, although the probability of such a risk arising was low. On the price front, members concurred that considerable uncertainty surrounded the outlook for international commodity prices with potential for movement in either direction, and that there was also a risk that inflation rates would deviate downward from the projection as a result of a decline in medium- to long-term inflation expectations.

Based on the examination from the two perspectives described above, members shared the view that some more time would be needed to confirm that price stability was in sight, and that due attention should be paid to the risk that the economic and price outlook would further deteriorate depending on developments in global financial markets and overseas economies. In light of this view, they agreed that, if they reached an agreement at this meeting on further enhancing monetary easing, the Bank's projection that Japan's economy would eventually return to a sustainable growth path with price stability in the longer run could be maintained.

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

Members agreed that the Bank, while steadily implementing the Asset Purchase Program (hereafter the Program) mainly through the purchase of financial assets in accordance with its decision in August to enhance monetary easing, should further enhance easing by increasing the total size of the Program so as to ensure a successful transition to a sustainable growth path with price stability.

Based on the members' view that an increase in the total size of the Program was appropriate, the chairman requested that the staff explain developments in markets for financial assets that were being purchased through the Program, the room left for additional purchases of these assets, and issues with respect to the Bank's financial soundness.

In response to the chairman's direction, the staff provided the following explanation.

(1) In view of the current market size of financial assets being purchased through the Program, constraints on additional purchases seemed unlikely to be particularly significant for the time being with regard to T-Bills and Japanese government bonds (JGBs) with a remaining maturity of about one to two years, whereas constraints on additional purchases could be larger with regard to CP, corporate bonds, and particularly Japan real estate investment trusts (J-REITs).

(2) With regard to market developments, although room for a further decline in yields on T-Bills was limited, there was still some room left for a decline in yields on JGBs with a remaining maturity of about one to two years. Credit spreads between CP at issuance and T-Bills as well as yield spreads between corporate bonds and JGBs remained stable at low levels.

(3) In terms of the Bank's financial soundness, due attention should be paid to the fact that additional purchases of exchange-traded funds (ETFs) entailed a high risk of price volatility. Constraints on additional purchases of T-Bills, JGBs, CP, and corporate bonds in view of ensuring the Bank's financial soundness seemed unlikely to be particularly significant for the time being.

In response to the staff's explanation, members held discussions and shared the view that it was appropriate to designate the increase in the Program for the purchase of JGBs and thereby encourage a further spread of the effects of monetary easing throughout financial markets, given that financial conditions continued to ease with smooth corporate funding in Japan despite unstable global financial markets.

Members concurred that, as the financing term used by Japanese firms was mainly in the range of around three years or less, it would be effective in further enhancing monetary easing to encourage a decline in interest rates of a roughly equivalent financing term, and therefore it was appropriate to continue to purchase JGBs with a remaining maturity of up to two years. A few members commented that the purchase of JGBs with a remaining maturity of one to two years was also effective in terms of ensuring stability in the foreign exchange market, considering the current situation where the correlation of the yen-dollar exchange rate with the two-year interest rate differential between Japan and the United States was high relative to its correlation with the interest rate differential of other maturities.

With regard to the possible amount of the Program's expansion, most members expressed the view that it was appropriate that the Bank increase the total size by about 5 trillion yen given that it had decided on a significant increase of about 10 trillion yen in August, taking full account in advance of various potential downside risks to the economy, and was currently in the process of steadily implementing the Program mainly through the purchase of financial assets in accordance with this decision. With regard to the schedule for completing all purchases after increasing the Program's size, some members expressed the opinion that it was appropriate for the Bank to maintain its decision to complete them by around the end of 2012 and thereby accelerate the pace of JGB purchases.

On this point, one member expressed the opinion that, as downside risks to economic activity and prices for the projection period were increasing with the decline in firms' and households' inflation and growth expectations, the amount of increase in the Program should be of enough size -- namely, about 10 trillion yen -- to have a notable impact akin to the August decision to enhance monetary easing.

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, 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 to 0.1 percent. A few members said that it was important to clearly present the Bank's strong determination to overcome deflation, and to explain consistently to the public that it would maintain the virtually zero interest rate policy until it judged that price stability was in sight.

As for the future conduct of monetary policy, members concurred that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank would continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. They also shared the view that, for these measures by the Bank to contribute to the strengthening of Japan's growth potential in the medium to long term, it was important for concerned parties in both the private and government sectors to continue making efforts in their respective roles while making use of the extremely accommodative financial conditions at present.

IV. Remarks by Government Representatives

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

(1) The Japanese economy had been picking up, but the pace was decelerating. In this situation, the one-sided movement of the yen's appreciation had intensified in the foreign exchange market as the yen appreciated rapidly and registered a historical high against the U.S. dollar. Moreover, the government was highly concerned that anxiety over debt problems in Europe had resurfaced, and that the slowdown in overseas economies was posing significant downside risks to the Japanese economy.

(2) With a view to appropriately responding without delay to the recent appreciation of the yen and the rapidly heightening risk of a hollowing-out of domestic industries, the Cabinet decided on October 21 the "Comprehensive Package Responding to the Yen Appreciation," which focused on the following: (1) further enhancement of financial support to small firms; (2) an increase in location subsidies to firms; and (3) the maximum use of merits of the yen's appreciation through Japanese firms' acquisitions of foreign firms and natural resources.

(3) The Cabinet decided the third supplementary budget for fiscal 2011. In the budget, funds were appropriated by priority for measures related to rebuilding following the disaster, as well as for measures to prevent the hollowing-out of domestic industries.

The government would make its utmost efforts to obtain the Diet's approval for the third supplementary budget.

(4) The government welcomed the Bank's proposal made at this meeting of further monetary easing as an appropriate response to the current severe economic conditions. It hoped that the Bank would continue taking decisive monetary policy actions while considering the effects on the Japanese economy of the developments in overseas economies and disturbances in the financial markets, including the foreign exchange market.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy had been picking up, but the pace was decelerating. As for the outlook, although the economy was expected to continue to pick up, there were significant downside risks to the economy such as unstable international financial developments, concerns over a slowdown in overseas economies, and the rapid appreciation of the yen. The effects of the damage caused by the flooding in Thailand also warranted careful attention.

(2) The Cabinet decided the "Comprehensive Package Responding to the Yen Appreciation" in order to respond to the downside risks to the economy and the risk of a hollowing-out of domestic industries, both stemming from the rapid appreciation of the yen. The government would make efforts to promptly obtain the Diet's approval for the third supplementary budget for fiscal 2011. In addition, for the package to quickly produce visible results, an intergovernmental taskforce -- consisting of senior vice-ministers and appointed agency officials -- would examine and manage the progress of implementation of the measures in the package based on Plan-Do-Check-Act (PDCA). The government asked for the Bank's cooperation in this regard.

(3) In the October 2011 *Outlook for Economic Activity and Prices*, the Bank projected that the year-on-year rate of change in the CPI would remain at around 0 percent for the time being and at around 0.5 percent through fiscal 2013. These projected figures were considered to be low compared to the "understanding." Since its introduction in 2006, the "understanding" had only been achieved in 2008. As the Japanese economy was still in a mild deflationary situation, it was important to prevent the economy from

falling into a vicious circle of appreciation of the yen and deflation, and the government and the Bank had been sharing the view that overcoming deflation was a policy priority. The government welcomed the Bank's proposal made at this meeting to enhance monetary easing as a timely action. It expected the Bank to continue to sufficiently exchange views and keep close contact with the government to underpin the economy through appropriate and decisive conduct of monetary policy.

V. Votes

A. Vote on the Guideline for Money Market Operations

Members shared the view 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 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.

> 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, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

Votes against the proposal: None.

B. Vote on "Amendment to 'Principal Terms and Conditions for the Asset Purchase Program'"

Most members expressed the view that it was appropriate to increase the total size of the Program by about 5 trillion yen, and to designate such an increase for the purchase of JGBs. One member, however, proposed to increase the amount of the Program by about 10 trillion yen. As a result, the following two policy proposals were submitted.

Mr. R. Miyao formulated a proposal to increase the total size of the Program by about 10 trillion yen, and to designate such an increase for the purchase of JGBs. The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. R. Miyao.

Votes against the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

To reflect the majority view, the chairman formulated a proposal to increase the total size of the Program by about 5 trillion yen, and to designate such an increase for the purchase of JGBs. The proposal was then put to a vote.

The proposal was decided by a majority vote.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

Votes against the proposal: Mr. R. Miyao.

Mr. R. Miyao dissented from the chairman's proposal, arguing that, as downside risks to economic activity and prices for the projection period were increasing with the decline in firms' and households' inflation and growth expectations, the amount of increase in the Program should be significant -- namely, about 10 trillion yen -- akin to the August decision.

VI. Discussion on the Public Statement Entitled Enhancement of Monetary Easing

On the basis of the above discussions, members discussed the statement Enhancement of Monetary Easing, which included the following: (1) the Bank's monetary policy stance that it would further enhance monetary easing by increasing the total size of the Program by about 5 trillion yen -- from about 50 trillion yen to about 55 trillion yen -- so as to ensure a successful transition to a sustainable growth path with price stability, based on the recognition that some more time would be needed to confirm that price stability was in sight, and that due attention should be paid to the risk that the economic and price outlook would further deteriorate depending on developments in global financial markets and overseas economies; and (2) the proposal formulated by Mr. R. Miyao. The statement was then put 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).

VII. Decision regarding the *Outlook for Economic Activity and Prices*

Members discussed the draft of the *Outlook for Economic Activity and Prices* (consisting of "The Bank's View" and "The Background"), and put "The Bank's View" to a vote. The Policy Board decided, by a unanimous vote, the text of "The Bank's View." It was confirmed that "The Bank's View" would be made public on October 27, 2011 and the whole report on October 28, 2011.

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

Votes against the proposal: None.

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 6 and 7, 2011 for release on November 1, 2011.

Attachment 1

October 27, 2011

Bank of Japan

Enhancement of Monetary Easing

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by an 8-1 majority vote,[4] to enhance monetary easing by increasing the total size of the Asset Purchase Program by about 5 trillion yen, from about 50 trillion yen to about 55 trillion yen.[5] The increase in the Program is designated for the purchase of Japanese government bonds.[6]

2. The Policy Board also decided, by a unanimous vote,[7] to set the following guideline for money market operations for the intermeeting period:

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

3. Japan's economic activity has continued picking up while the supply-side constraints have been gradually resolved. Meanwhile, financial conditions have continued to ease as issuing conditions for CP and corporate bonds have remained favorable and

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[4] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.
Voting against the action: Mr. R. Miyao.

[5] At today's meeting, Mr. Miyao proposed to increase the amount of the Asset Purchase Program by about 10 trillion yen, which would bring the total volume of the Program to about 60 trillion yen. The proposal was defeated by a majority vote. Voting for the proposal: Mr. R. Miyao. Voting against the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

[6] See Attachment 2 for the allocation of the increase in the Program.

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

firms' funding costs have declined moderately. As for the outlook, although an adverse effect from a slowdown in overseas economies and the appreciation of the yen will continue for the time being, Japan's economy is expected to return to a moderate recovery path because the pace of recovery in overseas economies will subsequently pick up and the demand related to reconstruction after the earthquake disaster will gradually materialize.

4. However, some more time will be needed to confirm that price stability is in sight and due attention is needed for the risk that the economic and price outlook will further deteriorate depending on developments in global financial markets and overseas economies. While steadily implementing its decision in August to enhance monetary easing, especially through the purchase of financial assets, the Bank deemed it necessary to further enhance monetary easing so as to ensure a successful transition to a sustainable growth path with price stability.

5. For the purpose of further enhancing the spread of monetary easing effect throughout financial markets, the Bank judged it appropriate to designate the 5 trillion yen increase in the Asset Purchase Program for the purchase of Japanese government bonds in consideration of the aforementioned current financial conditions with generally smooth corporate funding. In addition to purchases under the Program, the Bank regularly purchases Japanese government bonds at the pace of 21.6 trillion yen per year with the aim of providing funds in a stable manner broadly consistent with a trend increase in banknote demand.

6. The Bank will continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. For these measures by the Bank to contribute to the strengthening of Japan's growth potential in the medium to long term, it is important for concerned parties in both the private and government sectors to continue making efforts in their respective roles while making use of accommodative financial conditions.

Attachment 2

Increase in the Asset Purchase Program

1. Allocation of the Increase

(trillion yen)

	Program size before the increase	Amount of increase	Program size after the increase
Total size	**About 50**	**About +5**	**About 55**
Asset Purchases	15.0	+5.0	20.0
Japanese government bonds[Note]	4.0	+5.0	9.0
Treasury discount bills	4.5	—	4.5
CP	2.1	—	2.1
Corporate bonds	2.9	—	2.9
Exchange traded funds (ETFs)	1.4	—	1.4
Japan real estate investment trusts (J-REITs)	0.11	—	0.11
Fixed-rate funds-supplying operation against pooled collateral	35.0	—	35.0
Three-month term	20.0	—	20.0
Six-month term	15.0	—	15.0

Note: In addition to purchases under the Asset Purchase Program, the Bank regularly purchases Japanese government bonds at the pace of 21.6 trillion yen per year.

2. The Bank intends to complete the increased purchases by around the end of 2012.