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October 11, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on September 18 and 19, 2012

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Tuesday, September 18, 2012, from 2:00 p.m. to 4:56 p.m., and on Wednesday, September 19, from 9:00 a.m. to 12:39 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. R. Miyao
Mr. Y. Morimoto
Ms. S. Shirai
Mr. K. Ishida
Mr. T. Sato
Mr. T. Kiuchi

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance[2]
Mr. S. Sato, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. H. Ogushi, Parliamentary Secretary of Cabinet Office, Cabinet Office[2]
Mr. K. Matsuyama, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. H. Nakaso, Executive Director (Assistant Governor)
Mr. H. Hayakawa, Executive Director
Mr. N. Kinoshita, Executive Director
Mr. K. Momma, 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 4 and 5, 2012 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. Y. Fujita and H. Ogushi were present on September 19.
[3] Messrs. S. Sato and K. Matsuyama were present on September 18.

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

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

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

Mr. K. Kamada, 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. Kanno, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

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

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

[4] Messrs. T. Umemori and H. Kanno were present on September 19 from 10:34 a.m. to 12:39 p.m.

I. Summary of Staff Reports on Economic and Financial Developments[5]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on August 8 and 9, 2012, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[6] In this situation, the uncollateralized overnight call rate had been in the range of 0.075 to around 0.095 percent.

With regard to the operation of the Asset Purchase Program (hereafter the Program), there was a sufficient amount of bids in the Bank's outright purchases of treasury discount bills (T-Bills). As for the Bank's fixed-rate funds-supplying operation against pooled collateral (hereafter the fixed-rate operation), although undersubscription -- that is, aggregate bids falling short of the Bank's offers -- was still occurring, the Bank continued to work on increasing market participants' incentive to bid in the fixed-rate operation by, for example, setting the date of repayment flexibly. In a situation where yields on Japanese government bonds (JGBs) had declined to extremely low levels, undersubscription had intermittently occurred in the Bank's outright purchases of JGBs, particularly those with a remaining maturity of "one to two years."

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been stable at low levels. General collateral (GC) repo rates had been at around 0.1 percent. As for interest rates on term instruments, yields on T-Bills, including those with longer maturities, had been stable at around 0.1 percent. Issuance rates on T-Bills, meanwhile, had been marginally below 0.1 percent. Rates on longer-term interbank instruments had been more or less unchanged.

With regard to long-term interest rates, yields on 2-year JGBs had been stable at a level slightly below 0.1 percent. Yields on 10-year JGBs temporarily rose to around 0.85 percent, in reflection of the rise in U.S. long-term interest rates brought about by expectations for economic recovery in the United States. They subsequently declined somewhat, reflecting expectations for monetary easing in the United States, and had

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

[6] 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.

recently been at a level around 0.8 percent. The Nikkei 225 Stock Average rose to the range of 9,000-9,500 yen following the rise in U.S. and European stock prices, but declined to around 8,500 yen, reflecting deterioration in economic indicators in Japan and concern over an economic slowdown in China. It recovered thereafter and had been moving at around 9,000 yen recently. Prices for Japan real estate investment trusts (J-REITs) had been rising. Yield spreads between corporate bonds and JGBs continued to be more or less unchanged on the whole, reflecting solid demand from investors for corporate bonds. The yen temporarily dropped to the 79-80 yen range against the U.S. dollar as a result of better-than-expected U.S. economic indicators. It then appreciated to the 78-79 yen range, partly reflecting the monetary easing in the United States. The yen depreciated to the 102-103 yen range against the euro in light of the decision by the European Central Bank (ECB) to introduce the new modalities for undertaking Outright Monetary Transactions (OMTs).

C. Overseas Economic and Financial Developments

Overseas economies had moved somewhat deeper into a deceleration phase.

The U.S. economy generally continued to recover at a moderate pace, although signs of weakness were observed, such as in business sentiment. In the corporate sector, although production continued to increase moderately, business sentiment had become cautious due to the heightened uncertainty regarding the outlook, and growth momentum in business fixed investment had slowed. On the other hand, in the household sector, while the balance-sheet repair weighing on the economy had gradually been mitigated, private consumption was increasing moderately, reflecting a modest improving trend in the employment situation. Housing investment had also been picking up, albeit at a depressed level, partly supported by the low interest rate. As for prices, while slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, the year-on-year rate of increase in the consumer price index (CPI) for all items decelerated due to the effects of the earlier decline in gasoline prices. However, as gasoline prices had recently risen to a fairly large extent, due to the heightening of crude oil prices, the effects of such developments on the CPI had started to materialize.

Economic activity in the euro area had receded slowly. Growth in exports was slow. As for domestic demand, business fixed investment had been declining and private consumption was more or less unchanged. Furthermore, the weakening of household and business sentiment had been spreading from peripheral countries to core countries. Under these circumstances, production was declining. As for prices, although slack in supply and demand conditions was exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items accelerated somewhat, partly reflecting the recent rise in gasoline prices. Meanwhile, economic activity in the United Kingdom had been sluggish.

With regard to Asia, the pace of economic growth in China was slowing and the state of slowdown had been more prolonged than expected. Exports had been somewhat weak, reflecting the decrease in those to Europe. The rates of increase in fixed asset investment and private consumption had continued to decelerate somewhat. These slowdowns resulted from the deceleration in private real estate investment for the former and in car sales for the latter. Given such developments, the rate of increase in production was also decelerating, due in part to heightened pressure from inventory adjustments. Nevertheless, some signs of improvement were observed recently, such as an increase in infrastructure investment and an uptick in real estate sales. Regarding the NIEs and the ASEAN countries, although the pace of economic growth had picked up, it was starting to moderate, particularly in the corporate sector. As for domestic demand, while private consumption had been firm, the pace of increase in business fixed investment had moderated. Exports and production had been somewhat weak, mainly due to the decline in exports to Europe and China, and business sentiment had become cautious. As for prices, in many of the NIEs and the ASEAN countries, there was still upward pressure on prices, mainly reflecting the continued wage inflation caused by tight labor market conditions, but inflation rates remained more or less flat. In India, the economy continued to decelerate.

In global financial markets, although investors' risk aversion on the back of the European debt problem had abated somewhat, particular attention should be given to developments in these markets. Yield spreads of Spanish and Italian government bonds over German government bonds had tightened considerably, mainly due to the decision by the ECB to introduce the new modalities for undertaking OMTs. U.S. and European stock prices, after temporarily dropping in the latter half of August 2012, had risen thereafter partly due to the following factors: firmer-than-expected corporate results, such as those in the United States; expectations for monetary easing in the United States; and the decision by the ECB to introduce the new modalities for undertaking OMTs. While U.S. stock prices were rising, long-term interest rates in the United States had been at almost the same levels as at the time of the previous meeting as heightened expectations for monetary easing exerted downward pressure on the interest rates. Long-term interest rates in Germany had risen slightly compared with those at the time of the previous meeting, partly because demand for safe assets had abated, reflecting the policy action by the ECB. With regard to corporate bond markets in the United States and Europe, credit spreads on corporate bonds had been more or less unchanged. Stock prices and currencies in emerging and commodity-exporting economies had also been more or less unchanged on the whole. The funding conditions of European financial institutions continued to be stable on the whole. Spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates had narrowed somewhat as the ECB took its policy action. The U.S. dollar funding premium in the foreign exchange swap markets had also declined somewhat while spreads between interest rates on U.S. dollar-denominated term instruments and OIS rates were generally unchanged.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports and industrial production had been relatively weak as overseas economies had moved somewhat deeper into a deceleration phase. Although real exports, for the first time in three quarters, had risen in the April-June quarter of 2012 on a quarter-on-quarter basis, they had fallen back rather sharply in July compared with that quarter. Monthly figures showed that they had declined for three straight months through July after having risen in April. Exports and industrial production were expected to remain relatively weak for the time being and increase moderately thereafter as overseas economies gradually emerged from the deceleration phase. Judging from interviews with firms and other relevant information, industrial production was expected to decline in a wide range of industries in the July-September quarter. It was expected to turn upward, albeit marginally, in the October-December quarter. However, with the pick-up in overseas economies lagging behind, there was a high degree of uncertainty about whether this was likely to happen.

Public investment continued to increase, primarily in that related to reconstruction following the earthquake disaster. The amount of public construction completed -- a measure that reflected the progress of public works -- continued to rise in the April-June quarter following a quarter-on-quarter rise in the January-March quarter. The value of public works contracted -- a measure that reflected public works orders -- had also increased in the July-August period compared with the April-June quarter after having registered a higher quarter-on-quarter increase in April-June than in January-March. Against this background, public investment was expected to be on the rise.

Business fixed investment had been on a moderate increasing trend with improvement in corporate profits. It was expected to continue on this uptrend, partly due to investment related to disaster prevention and energy, as corporate profits kept improving on the whole, notwithstanding the effects of the deceleration in overseas economies for the time being.

The employment and income situation, although it remained severe, had generally been improving, as evidenced partly by the fact that (1) the ratio of job offers to applicants continued to improve and (2) the unemployment rate had been trending downward.

With the employment situation on an improving trend, private consumption had been resilient and was expected to remain so as this trend continued.

Housing investment had generally been picking up, supported in part by reconstruction of disaster-stricken homes, and was expected to continue picking up.

As for prices, international commodity prices as a whole continued to pick up. The three-month rate of change in the domestic corporate goods price index (CGPI) had been negative, mainly reflecting the earlier decline in international commodity prices. The CGPI was expected to decline at a reduced pace for the time being, reflecting movements in international commodity prices. The year-on-year rate of change in the corporate services price index (CSPI) for all items excluding international transportation, having seen a deceleration in the pace of decline, had recently been around 0 percent. The year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent, while the earlier fall in crude oil prices had been exerting downward pressure. It was expected to stay at this level for the time being.

2. Financial environment

Financial conditions were accommodative.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. As for credit demand, firms showed signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had risen somewhat. The year-on-year rate of change in the amount outstanding of CP had been positive. In contrast, that of corporate bonds, especially electric company bonds, had been negative. In these circumstances, firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock had been positive, within the range of 2-3 percent.

3. The fund-provisioning measure to support strengthening the foundations for economic growth

On September 6, 2012, the Bank carried out a new loan disbursement, amounting to 212.2 billion yen, under the main rules for the fund-provisioning measure to support strengthening the foundations for economic growth. The outstanding balance of loans disbursed by the Bank under these rules amounted to 3.186 trillion yen after the new loan disbursement, and thus exceeded 3 trillion yen, as in the previous loan disbursement. Under the special rules for equity investments and asset-based lending (ABL), the Bank's new loan disbursement was 3.6 billion yen and the outstanding balance of loans came to 109.4 billion yen. Regarding the special rules for small-lot investments and loans, the Bank's new loan disbursement amounted to 1.466 billion yen and the outstanding balance of loans came to 4.44 billion yen. The number of borrowers of loans disbursed by the Bank under the special rules increased significantly to 27 financial institutions, from nine in the previous loan disbursement, boosted by the fact that the unit of loans to be disbursed by the Bank had been lowered from 100 million yen to 1 million yen as of this disbursement. The breakdown by area of loans provided by financial institutions that had received the Bank's loans under the special rules showed that "medical and nursing care," "setting up a new business," and "business reorganization" accounted for large proportions. This suggested that the Bank's provision of loans under the special rules could be effective in terms of exploring new sources of demand for funds, aside from the major areas covered by the loans provided under the main rules.

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

A. Economic Developments

In terms of global financial markets, members agreed that, while investors' risk aversion on the back of the European debt problem had abated somewhat, particular attention should be given to developments in these markets. Regarding the new modalities for undertaking OMTs introduced by the ECB in early September 2012, they expressed the view that these had been effective to a considerable extent in relieving serious market concern that had been factored into a rise in the long-term interest rates in countries such as Spain and Italy. Some members then commented that liquidity provision by central banks, including the policy action by the ECB, would only provide a temporary reprieve -- that is, serve as a measure to buy time -- and this would mitigate an economic downturn that had resulted from a cyclical factor. These members continued that it was therefore necessary to promptly implement structural reforms such as drastic fiscal reforms, labor market reforms, and reforms aimed at stabilizing and strengthening the financial system in order to fundamentally resolve the European debt problem.

Members concurred that overseas economies had moved somewhat deeper into a deceleration phase. As for the outlook, they shared the view that these were likely to remain in the deceleration phase for the time being but gradually emerge from it thereafter. Regarding the point that overseas economies had moved somewhat deeper into the deceleration phase, many members said that this was primarily attributable to a global deterioration in business sentiment amid a spreading of the effects of the European debt problem. One of these members commented that, since the previous meeting, in many countries and regions, the pace of the deceleration had become more advanced, particularly in the manufacturing sector. This member continued that the global economic downturn observed during the intermeeting period -- as evidenced by the deterioration in indicators of business sentiment -- was more severe than expected. One member, noting that issues of concern had been increasing gradually since the July 2012 interim assessment, said that overseas economies had moved somewhat deeper into the deceleration phase, judging from information gathered to date. A few members pointed to the possibility that the medium- to long-term growth rates of overseas economies had been declining, reflecting factors such as the effects of balance-sheet adjustments following the Lehman shock.

Members shared the recognition that economic activity in the euro area had receded slowly as the adverse impact of the European debt problem spread from peripheral countries to core countries. They also agreed that its economy was likely to continue to recede slowly for the time being given that fiscal austerity and severe financial conditions were likely to persist, particularly in peripheral countries. One member noted that, as represented in the recent Ifo Business Climate Index, business and household sentiment had been weakening even in Germany -- one of the core countries in the euro area -- and that the economic activity of Germany had been restrained due to deteriorating sentiment among economic agents. One member expressed the view that, although tail risks stemming from the European debt problem had subsided somewhat, the adverse feedback loop among the fiscal situation, the financial system, and economic activity in Europe had been intensifying to a greater level than expected. A few members said that the recession in the euro area economy was exerting downward pressure on the global economy through a contraction in global trade. These members noted that, due to the effects of such developments, exports of China, as well as of the NIEs and the ASEAN countries, had been somewhat weak.

Members shared the view that the pace of economic growth in China was slowing, and that the state of slowdown had been prolonged mainly due to the decline in exports to Europe and heightened pressure from inventory adjustments. As for the outlook, they concurred that, although the Chinese economy was likely to gradually show clear signs of recovery, the timing of such recovery would be delayed. One member, referring to the fact that the amount of increase in new lending by financial institutions was already expanding, said that a recovery trend was likely to become evident, particularly in real estate investment. In contrast, a few other members pointed out that considerable time might be required for inventory adjustments to be completed considering that production cuts in, for example, iron and steel -- which were in excess supply -- had not made much progress. As background to the prolonged slowdown in the Chinese economy, one member said that there was a possibility that the intended policy effects had been undermined due to structural problems, such as banks' nonperforming-loan problem. With regard to the stimulus measures by the Chinese authorities that had been approved in early September 2012, some members commented that these represented a deliberate approach compared to the policy measures adopted after the Lehman shock, and thus their effects would likely be limited. On this point, a few members suggested that the Chinese authorities might have been somewhat reluctant to introduce aggressive stimulus measures, as those implemented after the Lehman shock had triggered problems such as an overheating in the real estate market and an increase in banks' nonperforming loans. One member pointed out that the stimulus measures were mainly implemented in the area of real estate investment, and therefore positive effects on Japan's exports would be limited. One member commented that, from a relatively long-term perspective, the Chinese economy faced the challenge of whether it could make a smooth transition from high growth to stable growth while dealing with (1) shift in its economic structure from one that depended heavily on fixed asset investment and (2) problems that would arise from the shrinking of the population. A different member said that the Chinese economy faced the task of transitioning from "quantity-based" economic growth -- where an increase in the size of the economy and a high growth rate were being pursued -- to "quality-based" growth, brought about mainly by fostering high value-added industries and increasing consumption. This member, however, continued that it was less likely that the Chinese economy would make a hard landing considering that its growth potential remained high. One member expressed the view that momentum toward economic recovery might have weakened due to structural factors.

Regarding the NIEs and the ASEAN countries, members concurred that the pace of economic growth had picked up on the whole, as private consumption and business fixed investment had been firm, due mainly to policy measures such as monetary easing. They continued, however, that exports and production had been somewhat weak, mainly due to the decline in exports to Europe and China.

As for the U.S. economy, members agreed that it generally continued to recover at a moderate pace -- although signs of weakness were observed, such as in business sentiment -- and that it was likely to continue to do so, supported mainly by the accommodative financial conditions. Some members said that, although households and firms found it difficult to be active with their spending amid persisting strains from balance-sheet adjustments, some positive signs had been observed in the household sector, such as a pick-up in the housing market. On the other hand, some members noted that some weakness had been seen in the corporate sector, such as the decrease in production and the deterioration in business sentiment. As a notable feature of the U.S. economy over the past decade or so, one member pointed to the growing mismatch between the supply and demand of labor, as evidenced by the significant decrease in employment of medium-skilled workers during the economic recession and the lack of improvement despite the recovery of the economy. This member continued that the current elevated unemployment rate level might reflect a transition process in which cyclical unemployment turned into structural unemployment. Regarding the measure decided by the Federal Open Market Committee (FOMC) in mid-September 2012, some members commented that this could be expected to support the moderate recovery in the U.S. economy from the financial side. One member expressed the view that concern about the "fiscal cliff" -- a state in which fiscal spending cuts and tax increases would be implemented simultaneously at the beginning of 2013 -- was already exerting downward pressure on business sentiment. A different member said that the effects of the "fiscal cliff" had not yet been fully factored in by the markets, for example, and thus future developments required careful monitoring.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy.

Regarding recent developments in the economy, members shared the recognition that it had registered relatively high growth in the first half of 2012, supported by the firmness in domestic demand; nonetheless, the pick-up in economic activity had come to a pause as overseas economies had moved somewhat deeper into a deceleration phase. They agreed that exports and industrial production had been relatively weak, reflecting the aforementioned developments in overseas economies. Some members pointed out that inventory adjustments at home and abroad were exerting downward pressure on exports and production. One member said that the ratio of new job offers to applicants was declining, reflecting relatively weak developments in the manufacturing sector. Members concurred that public investment continued to increase, primarily in that related to reconstruction following the earthquake disaster, and that housing investment had generally been picking up. They shared the recognition that business fixed investment had been on a moderate increasing trend with improvement in corporate profits. On this basis, some members pointed out that somewhat weak developments were observed in some coincident and leading indicators of business fixed investment. Members concurred that private consumption had been resilient with the employment situation on an improving trend. On this basis, some members noted that there were signs of weakness in some indicators, reflecting the waning effects of subsidies for purchasers of environmentally friendly cars and somewhat low bonuses in the summer. A few members commented that, although domestic demand had been resilient, recently there were issues of concern.

As for the outlook for the economy, members agreed that it was likely to level off more or less for the time being. They then shared the recognition that exports and industrial production would probably remain relatively weak for the time being; however, although domestic demand was likely to remain resilient, mainly supported by reconstruction-related demand, a substantial increase in such demand, which would thereby compensate for the weakness in exports and industrial production, could no longer be expected. One member said that real GDP was likely to remain more or less unchanged, or that its growth rate would remain at a considerably low level for the time being. A different member said that the results of the August 2012 *Economy Watchers Survey* -- a survey considered effective in terms of showing the future direction of the economy -- indicated that the economy remained sluggish. Members agreed that the economy was likely to return to a moderate recovery path, but that the timing would probably be delayed considerably compared to what had been projected in the April 2012 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). Some members expressed the view that, although there was great uncertainty regarding such timing because this depended on when overseas economies would recover, the delay was likely to be about six months.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent, while the earlier fall in crude oil prices had been exerting downward pressure. They shared the recognition that it was likely to stay at this level for the time being. One member said that the year-on-year rate of decline in the CPI was unlikely to accelerate further, based on, for example, the developments in gasoline prices and increase in electricity charges. This member, however, noted that it was necessary to carefully examine changes in price trends, excluding these factors. A few members commented that price indicators such as the trimmed mean CPI had been relatively weak for the past few months, and that price trends might be weakening somewhat. One member said that, given the developments in wages, a cautious view regarding the outlook for prices was inevitable. Some members said that, if the economy more or less leveled off for the time being, the pace of improvement in the negative output gap might slow, leading to some deceleration in the pace of increase in the CPI.

With regard to risks to the outlook for Japan's economic activity and prices, members concurred that there remained a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. They continued that, furthermore, attention should be paid to the effects of financial and foreign exchange market developments on economic activity and prices. Most members pointed out that the effects of the "fiscal cliff" in the United States might become more intense toward the year-end, in the form of deterioration in business sentiment and restraint in firms' stance on fixed investment. One of these members commented that attention needed to be paid to the possibility that, if fiscal austerity measures were implemented amid persisting strains from households' balance-sheet adjustments, their effects could weigh more heavily on economic recovery than expected. A few members expressed concern that, if the deceleration in overseas economies was prolonged, the negative impact on corporate profits and the employment and income situation could feed through into domestic demand, thereby constraining the virtuous circle from operating properly. A few members said that it was necessary to closely monitor whether the appreciation of the yen and the fall in stock prices would exert a negative impact on business fixed investment and private consumption through deterioration in business and household sentiment. One member pointed out that, in the face of such various risk factors, Japan's economy would continue to be highly vulnerable to negative shocks for some time. With regard to risks to the outlook for prices, one member -- noting that short-term inflation expectations continued to be at a low level -- said that careful attention should be paid to such developments since they could lead to a slowdown in the pace at which the rate of inflation converged with the level considered stable from a medium- to long-term perspective; that is, the inflation anchor.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative.

Members agreed that the money market had been extremely stable, as the Bank had been pursuing powerful monetary easing and the soundness of financial institutions' balance sheets had been maintained. They shared the view that issuing conditions for CP remained favorable, as did those for corporate bonds on the whole. They were of the view that firms' funding costs had declined moderately, and that the availability of funds remained on an improving trend. One member pointed out that, although demand for bank loans had risen somewhat, reflecting firms' stance to increase business fixed investment, the loan-to-deposit ratio remained low.

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

Based on the above assessment of economic and price developments, members discussed monetary policy for the immediate future.

Regarding the guideline for money market operations for the intermeeting period ahead, 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.

With regard to the operation of the Program, members shared the recognition that, considering that economic and price developments were weakening and would likely continue to do so for the time being, it was appropriate at this time to further enhance monetary easing by increasing the total size of the Program in order to prevent Japan's economy from deviating from a return to a sustainable growth path with price stability. Some members said that, as long as it was evident at this point that the recent economic situation in Japan was weaker than projected, the Bank should take policy actions now, rather than wait until making an assessment in the October 2012 Outlook Report. One of these members noted that, if policy responses were behind the curve, there was a risk that the credibility of the Bank's monetary policy might be undermined, and therefore it was necessary that the Bank clearly indicate to the market its stance on such policy by taking action at this time.

With regard to the size of increase in the Program, members shared the view that it would be appropriate for the Bank to make a substantial increase, such as by about 10 trillion yen. They then agreed that, taking into account the effects on the entire yield curve, it would be appropriate for the Bank to purchase large amounts of T-Bills and JGBs in a balanced manner. Most members were of the opinion that it would be appropriate at this meeting to earmark the increase in the Program for the purchases of T-Bills and JGBs, taking account of the current situation where corporate funding was generally proceeding smoothly. One member expressed the view that, together with these purchases of government securities, increasing the size of purchases of risk assets would further encourage a reduction in risk premiums and thereby have a positive impact in terms of strengthening the transmission mechanism of the effects of the purchases of government securities. A different member expressed the view that it might be necessary for the Bank to devise further ways to boost inflation expectations, such as exerting influence on foreign exchange rates. Members shared the view that, given that undersubscription was occurring in the Bank's outright purchases of JGBs, it would be appropriate for the Bank to remove the minimum bidding yield in order to ensure smooth purchases, including the additional amount discussed at this meeting.

Based on the above discussion, the chairman requested that the staff explain the room left for additional purchases of various financial assets in view of the Bank's risk tolerance and the market size of these assets. The staff provided the following explanation. First, the Bank would be able to purchase T-Bills and JGBs even after increasing the amount of purchases of those assets, given the stock and flow -- the amount outstanding in the markets and the amount issued -- of these securities. Second, the amount of risk incurred by making additional purchases could be sufficiently absorbed by the Bank's capital. And third, the amount of risk incurred by making additional purchases of risk assets would be significantly larger than that of government securities. In response to this explanation, members discussed the specifics of the proposal to further enhance monetary easing. They agreed that it would be appropriate for the Bank to substantially increase the total size of the Program, by about 10 trillion yen, from about 70 trillion yen to about 80 trillion yen. Members then concurred that the increase should be earmarked for the purchases of T-Bills and JGBs -- about 5 trillion yen for each. They shared the view that it would be appropriate for the Bank to complete the increased purchases under the Program by around end-2013; specifically, additional purchases of T-Bills and JGBs would be completed by around end-June 2013 and around end-2013, respectively. Regarding the extension of the term for completing the increased purchases under the Program to end-2013, some members commented that this provided guidance for the future conduct of monetary policy, which in turn was expected to be beneficial in enhancing policy duration effects. As for the decision made by the FOMC in mid-September 2012 to purchase additional agency mortgage-backed securities (MBSs), one member said that attention was focused on the fact that the purchases would be made without setting a ceiling and a time limit beforehand. This member continued that the Bank had repeatedly expanded the total size of the Program and extended the term for completing the increased purchases under the Program, and thus was conducting large-scale and long-term monetary easing whose size and duration were substantially exceeding the initial plan.

Members shared the recognition that, when increasing the size of the Program, it would be appropriate to remove the minimum bidding yield for outright purchases of JGBs in order to ensure smooth purchases. They continued that it would also be appropriate to remove the minimum bidding yield for outright purchases of corporate bonds, which were another type of long-term asset. With regard to the removal of the minimum bidding yield, a few members noted that this would enable the Bank to conduct outright purchases of JGBs smoothly even at interest rate levels at which -- depending on the prevailing market rates -- it had been unable to purchase previously, and could bring about a decline in longer-term market interest rates. On this basis, one member said that the combination of an increase in the size of the Program and the removal of the minimum bidding yield would generate more powerful monetary easing effects.

Members shared the view that these measures in pursuit of powerful monetary easing would make financial conditions for such economic entities as firms and households even more accommodative by further encouraging a decline in longer-term market interest rates and a reduction in risk premiums. On this basis, they agreed that such enhancement of monetary easing -- together with the cumulative effects of earlier policy measures -- would ensure the return of Japan's economy to a sustainable growth path with price stability.

Members reaffirmed their view that Japan's economy faced the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. They concurred that, based on the recognition that this challenge would be met through efforts by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side, the Bank had been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. Members also shared the view that the Bank would proceed with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program. They then agreed that it would continue to conduct monetary policy in an appropriate manner and do its utmost to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets.

IV. Remarks by Government Representatives

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

(1) The first step toward achieving fiscal consolidation had been taken, with the government obtaining the Diet's approval of bills related to the comprehensive reform of the social security and taxation systems. The government would continue to do its utmost to achieve fiscal consolidation. In addition, it recently compiled the fiscal 2013 budget request. The government would promote Japan's economic growth and follow the "Medium-Term Fiscal Framework" by reviewing budget expenditure thoroughly and placing its primary focus on making budget allocations to priority areas.

(2) In the September 2012 issue of the *Monthly Economic Report*, the government revised its economic assessment downward for the second consecutive month. The economic recovery in Japan appeared to be pausing recently, due to deceleration of the world economy; as for the outlook, a further slowing down of overseas economies and sharp fluctuations in the financial markets would pose downside risks to the Japanese economy. The rapid appreciation of the yen and the fact that it remained elevated, in particular, could pose significant downside risks to the Japanese economy, and therefore the government would continue to monitor market developments attentively and take decisive measures as necessary.

(3) The government deemed it important that the Bank take appropriate actions without delay, in view of the fact that the current economic situation was increasingly severe and the downside risks to the economy had heightened, partly due to the rapid appreciation of the yen. The government thus welcomed the Bank's proposal made at this meeting on additional monetary easing and the removal of the minimum bidding yield for outright purchases, such as of JGBs, as a timely and appropriate action.

(4) The government and the Bank shared the view that overcoming deflation was an important task in Japan, and had been making policy efforts while sufficiently exchanging views and keeping close contact. The government expected the Bank to continue to conduct monetary policy vigorously and decisively based on the Bank's

stance that, for the time being, it would pursue powerful monetary easing with the aim of achieving the goal of 1 percent in terms of the year-on-year rate of increase in the CPI, and continue to do so until it judged the 1 percent goal to be in sight. In conducting monetary policy, the government also expected the Bank to monitor developments in economic activity and financial markets at home and abroad while working sufficiently on its communication to the public in an effort to make its policy stance fully understood.

The representative from the Cabinet Office made the following remarks.

(1) The economic recovery in Japan appeared to be pausing, as evidenced by weak exports and production due to deceleration of the world economy. As for the outlook, it was likely that movements toward economic recovery would pause for the time being, and since there was a risk that a further slowing down of overseas economies and sharp fluctuations in the financial markets would exert downward pressure on the Japanese economy, it was deemed necessary to monitor the situation with greater vigilance. In addition, although the rate of decline in prices was moderating, recent price developments indicated that the Japanese economy remained in a mild deflationary situation.

(2) At the recent Ministerial Council on Exiting Deflation, which a representative of the Bank attended as an observer, the government reaffirmed that it would work closely with the Bank to overcome deflation. It would vigorously carry out various measures aimed at overcoming deflation, which were included in the "Comprehensive Strategy for the Rebirth of Japan," and thereby raise Japan's growth potential.

(3) The government expected the Bank to continue to make its utmost efforts in the conduct of monetary policy in parallel with these government measures. The government deemed it particularly important for the Bank to produce visible results by achieving as promptly as possible a CPI inflation rate of 1 percent, the rate the Bank aimed to achieve for the time being. In addition, it expected the Bank to respond in an appropriate manner to downside risks to the Japanese economy, including effects that could arise from monetary policies conducted overseas -- for example, in the United States. The Bank's proposal on monetary easing made at this meeting was deemed a timely action. The government expected the Bank to continue with steady

implementation of the purchases of financial assets and powerful monetary easing until the exit from deflation was ensured.

V. Votes

A. Vote on the Guideline for Money Market Operations

Based on the above discussions, 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. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.

Votes against the proposal: None.

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

With a view to further enhancing monetary easing, members shared the recognition that it was appropriate to make the following changes with respect to the Program: (1) an increase in the total size of the Program by about 10 trillion yen, which corresponded to additional purchases of T-Bills of about 5 trillion yen and JGBs of about 5 trillion yen; and (2) a removal of the minimum bidding yield for outright purchases of JGBs and corporate bonds. "Amendment to 'Principal Terms and Conditions for the Asset Purchase Program'" was then put to a vote. Members voted unanimously to approve the amendment and agreed that the decision should be made public accordingly.

VI. Discussion on the Statement Entitled Enhancement of Monetary Easing

On the basis of the above discussions, members discussed the statement Enhancement of Monetary Easing, which included a description of the increase in the total size of the Program. 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. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of August 8 and 9, 2012 for release on September 24, 2012.

Attachment 1

September 19, 2012

Bank of Japan

Enhancement of Monetary Easing

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan made the following decisions, by a unanimous vote, regarding the Asset Purchase Program (hereafter referred to as "the Program") with a view to further enhancing monetary easing.

   (1) The Bank decided to increase the total size of the Program by about 10 trillion yen, from about 70 trillion yen to about 80 trillion yen. The increase in the size of the Program corresponds with the size of additional purchases of treasury discount bills (T-Bills) by about 5 trillion yen and Japanese government bonds (JGBs) by about 5 trillion yen.

   The increased purchases under the Program will be completed by around end-2013. Specifically, additional purchases of T-Bills and JGBs will be completed by around end-June 2013 and around end-2013, respectively. Through these measures, the amount outstanding of the Program will be about 65 trillion yen by around end-2012, about 75 trillion yen by around end-June 2013, and about 80 trillion yen by around end-2013.[7]

   (2) The Bank decided to remove the minimum bidding yield (currently 0.1 percent per annum) for the outright purchases of JGBs and corporate bonds in order to ensure their smooth purchase.

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[7] See Attachment 2 for an overview of the Program.

2. The Policy Board also decided, by a unanimous vote, 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. Overseas economies have moved somewhat deeper into a deceleration phase. In global financial markets, while investors' risk aversion on the back of the European debt problem has abated somewhat, particular attention should be given to developments in these markets.

4. Japan's economy registered relatively high growth in the first half of 2012, supported by the firmness in domestic demand. Nonetheless, the pick-up in economic activity has come to a pause, reflecting the aforementioned developments in overseas economies. The year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent, while the earlier fall in crude oil prices has been exerting downward pressure. Against the backdrop of these developments, economic activity is expected to level off more or less and the year-on-year rate of change in the CPI to remain at around 0 percent for the time being.

   Regarding risks, there remains a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. Furthermore, attention should be paid to the effects of financial and foreign exchange market developments on economic activity and prices.

5. Based on these economic and price developments, the Bank of Japan judged it appropriate to expand the total size of the Program substantially by about 10 trillion yen and take the aforementioned measure to ensure the steady implementation of asset purchases. These measures in pursuit of powerful monetary easing will make financial conditions for such economic entities as firms and households even more

accommodative by further encouraging a decline in longer-term market interest rates and a reduction in risk premiums. The Bank expects that, together with the cumulative effects of earlier policy measures, today's decision to enhance monetary easing will ensure the return of Japan's economy to a sustainable growth path with price stability.

6. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. This challenge will be met through efforts by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side. Based on this recognition, the Bank has been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. It will proceed with the monetary easing in a continuous manner by steadily increasing the amount outstanding of the Asset Purchase Program. The Bank continues to conduct monetary policy in an appropriate manner. The Bank will also do its utmost to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets.

Attachment 2

Size of the Asset Purchase Program

(trillion yen)

	Program size at the time of establishment (October 2010)	Program size before today's decision		Program size after today's decision			Change in amount
Intended timescale for completing the purchases	End-December 2011	End-December 2012	End-June 2013	End-December 2012	End-June 2013	End-December 2013	
			(A)			(B)	(B) - (A)
Total size [Note 1]	**About 35**	**About 65**	**About 70**	**About 65**	**About 75**	**About 80**	**About +10**
Asset purchases	5. 0	40. 0	45. 0	40. 0	50. 0	55. 0	+10. 0
JGBs [Note 2]	1. 5	24. 0	29. 0	24. 0	29. 0	34. 0	+5. 0
T-Bills	2. 0	9. 5	9. 5	9. 5	14. 5	14. 5	+5. 0
CP	0. 5	2. 1	2. 1	2. 1	2. 1	2. 1	―
Corporate bonds	0. 5	2. 9	2. 9	2. 9	2. 9	2. 9	―
Exchange-traded funds (ETFs)	0. 45	1. 6	1. 6	1. 6	1. 6	1. 6	―
Japan real estate investment trusts (J-REITs)	0. 05	0. 12	0. 12	0. 12	0. 12	0. 12	―
Fixed-rate funds-supplying operation against pooled collateral	30. 0	25. 0	25. 0	25. 0	25. 0	25. 0	―

Notes: 1. The amount outstanding of the Program is 60.2 trillion yen as of September 10, 2012.
2. In addition to purchases under the Program, the Bank regularly purchases JGBs at the pace of 21.6 trillion yen per year.