Not to be released until 8:50 a.m. Japan Standard Time on Friday, November 2, 2012.

November 2, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 4 and 5, 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 Thursday, October 4, 2012, from 2:00 p.m. to 5:04 p.m., and on Friday, October 5, from 8:59 a.m. to 12:09 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. K. Takemasa, 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. S. Maehara, Minister of State for Economic and Fiscal Policy, Cabinet Office[4]

Mr. K. Matsuyama, Vice Minister for Policy Coordination, Cabinet Office[5]

Reporting Staff

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

Mr. H. Hayakawa, 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 30, 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 Mr. K. Takemasa was present on October 5.

3 Mr. S. Sato was present on October 4.

4 Mr. S. Maehara was present on October 5 from 10:57 a.m. to 12:09 p.m.

5 Mr. K. Matsuyama was present on October 4 for the whole of the session, and on October 5 from 8:59 a.m. to 10:56 a.m.

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director

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

Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department[6]

Mr. K. Kamiyama, Head of Policy Planning Division, Monetary Affairs Department

Mr. S. Aoki, Director-General, Financial Markets 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[6]

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

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

Mr. K. Masaki, Head of Market Operations Division, Financial Markets Department[6]

6 Messrs. T. Umemori, H. Kanno, and K. Masaki were present on October 5 from 8:59 a.m. to 9:11 a.m.

I. Summary of Staff Reports on Economic and Financial Developments[7]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on September 18 and 19, 2012, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[8] In this situation, the uncollateralized overnight call rate had been in the range of 0.075-0.095 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 both treasury discount bills (T-Bills) and Japanese government bonds (JGBs). As for the Bank's fixed-rate funds-supplying operation against pooled collateral (hereafter the fixed-rate operation), as evidenced by the fact that undersubscription had occurred only once since the previous meeting, a sufficient amount of bids had generally been observed, partly reflecting seasonal demand for funds accompanying the issuance and redemptions of JGBs.

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 either 0.1 percent or a level slightly below 0.1 percent. Yields on 10-year JGBs had recently declined marginally, to around 0.75 percent, in line with the decline in U.S. long-term interest rates that was brought about primarily by concern over the European debt problem. The Nikkei 225 Stock Average had inched down, due in part to concern over an economic slowdown in China and to sluggish U.S. and European stock prices, mainly reflecting uncertainty regarding the situation in Europe; it had been moving in the range of 8,500-9,000 yen recently. Prices for Japan real estate investment trusts (J-REITs) had

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

[8] 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.

continued to rise. 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 had generally been moving within the range of 78-79 yen against the U.S. dollar, albeit with fluctuations. The yen temporarily appreciated to the 99-100 yen range against the euro in an environment where uncertainty about the situation in Europe was drawing attention. It depreciated thereafter and had recently been in the 101-102 yen range.

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 in the corporate sector. Business sentiment had become cautious due mainly to the heightened uncertainty regarding the outlook, and growth momentum in production and 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, mainly reflecting a modest improving trend in the employment situation. Housing investment had also continued to pick up, albeit at a depressed level, partly supported by the low interest rate. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items picked up due to the effects of the rise in gasoline prices, whereas the year-on-year rate of increase in the CPI for all items less food and energy, or the core CPI, decelerated somewhat, partly reflecting the rise in automobile prices a year earlier owing to the effects of the Great East Japan Earthquake.

Economic activity in the euro area had receded slowly. Amid the situation of the protracted European debt problem, the weakening of sentiment had been spreading from firms to households and from peripheral countries to core countries. Under these circumstances, business fixed investment had been declining and signs of weakness were observed in private consumption, particularly of durable goods. Growth in exports was slow. Given such developments in demand, production was on a declining trend. 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 rise in gasoline prices. Meanwhile, economic activity in the United Kingdom had been sluggish.

With regard to Asia, the state of economic slowdown in China had been prolonged. Exports had been somewhat weak, reflecting the decrease in those bound for 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 in demand, inventory adjustment pressures were heightening, and the rate of increase in production was decelerating. Nevertheless, mainly reflecting the effects of stimulus measures adopted since May 2012, 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 moderating, particularly in the corporate sector. Exports and production had been somewhat weak, mainly due to the decline in exports bound for Europe and China, and business sentiment had become cautious. Under these circumstances, growth in business fixed investment had been sluggish. On the other hand, private consumption had been firm. As for prices, in many of these Asian economies, 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 be in a state of deceleration.

In global financial markets, while investors had remained somewhat less risk averse on the back of the European debt problem, 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 at one point, mainly in response to the decision by the European Central Bank (ECB) to introduce the new modalities for undertaking Outright Monetary Transactions (OMTs). However, in a situation where uncertainty regarding future developments had not yet been eliminated, some widening in these spreads was also observed recently. U.S. and European stock prices had dropped slightly compared with those at the time of the previous meeting, due mainly to concerns regarding the European debt problem and the deceleration in the global economy. In this situation, long-term interest rates in the United States and Germany had been declining somewhat. With regard to corporate bond markets in the United States and Europe, credit spreads had been more or less unchanged. Stock prices and currencies in emerging and commodity-exporting economies had been weakening somewhat, mainly on the back of uncertainty regarding the situation in Europe. 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 been on a narrowing trend since the ECB undertook its policy action. Spreads between interest rates on U.S. dollar-denominated term instruments and OIS rates had been on a narrowing trend, and the U.S. dollar funding premium in the foreign exchange swap markets had been at a low level.

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 fell back sharply in the July-August period compared with that quarter. Monthly figures showed that they had declined for four straight months through August 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. For the October-December quarter, although there was still a high degree of uncertainty, it seemed likely that production as a whole would remain relatively weak, mainly since the pick-up in overseas economies had lagged behind.

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 July relative to the April-June quarter, after having increased for four straight quarters through that 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 as corporate profits improved on the whole. It was expected to continue on this uptrend -- albeit impacted for the time being by the deceleration in overseas economies -- partly due to investment related to disaster prevention and energy, as corporate profits kept improving on the whole. Business fixed investment plans for fiscal 2012 (including software investment and excluding land purchasing expenses; all-size enterprise and all-industry basis) in the September 2012 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) were revised upward from those in the June *Tankan*, and registered a year-on-year increase of 7.2 percent, which was relatively higher than in normal years.

The employment and income situation, although it remained severe, had generally been improving. The ratio of job offers to applicants continued its improving trend, and the unemployment rate had been trending downward, albeit with fluctuations.

With the employment situation on an improving trend, private consumption had been resilient and was expected to remain so as this trend continued, although car sales were expected to fall back for the time being following the ending of subsidies for purchasers of environmentally friendly cars.

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 had picked 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 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. 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 had been hovering at low levels. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP and corporate bonds 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.

With regard to loan disbursements under the funds-supplying operation to support financial institutions in disaster areas over the past six months since the Bank's decision to extend the deadline for new applications for loans at the March 2012 meeting, the outstanding balance of loans rose to a record high of 511.2 billion yen in April following the twelfth loan disbursement. It had been at around 400 billion yen recently.

Regarding the fund provision based on "Special Rules for the U.S. Dollar Lending Arrangement to Enhance the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth," the Bank decided in August 2012 to delay the first disbursement, following developments regarding the reform of LIBOR -- the interest rate applied to loans under the special rules -- among interested parties. In light of subsequent progress made toward the reform of LIBOR on the premise that it would be maintained as a benchmark rate, the Bank decided to implement the first disbursement of its fund provision in October. It would implement the second disbursement from the end of November through the beginning of December 2012 after receiving financial institutions' requests for confirmation of individual investment or lending by October 17, as scheduled.

II. Amendment to Guidelines on Eligible Collateral

A. Staff Proposal

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

B. Discussion by the Policy Board and Vote

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

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

A. Economic Developments

In terms of global financial markets, members agreed that, while investors had remained somewhat less risk averse on the back of the European debt problem, particular attention should be given to developments in these markets. Many members pointed out that yields on government bonds issued by some peripheral European countries had declined somewhat, mainly reflecting the introduction of the new modalities for undertaking OMTs by the ECB. These members continued, however, that there remained a high degree of uncertainty in the markets, particularly regarding (1) whether or not Spain would ask for a full-scale financial bailout from other euro area countries and (2) progress toward establishing a single banking supervisory mechanism in the euro area. A few members added that, in Europe, progress had not been made among countries in terms of seeking agreement on the conditionalities for financial assistance to peripheral countries or with regard to identifying the direction to be taken in the euro area integration, thereby leading to the repeat of a situation where the motivation to take coordinated policy actions weakened and a conflict of interests among European countries surfaced whenever markets more or less regained stability. Some members then noted that, in order to eliminate concern over the European debt problem and ensure financial market stability, it was essential to promptly implement measures to stabilize and strengthen the financial system and put drastic fiscal and economic structural reforms into effect. One member expressed the view that market participants had perceived the results released at end-September 2012 of the stress tests conducted on Spanish banks as reassuring, and this could possibly be a factor that would put an end to a further deterioration in economic and financial developments. A different member said that, since the premises of the stress tests had been questioned by some market participants, it was necessary to continue to closely monitor whether the Spanish financial system would move toward stabilization.

Members concurred that overseas economies had moved somewhat deeper into a deceleration phase. As for the outlook, they shared the view that these economies were likely to remain in this phase for the time being but gradually emerge from it thereafter. Regarding the point that overseas economies had moved somewhat deeper into such a phase, some members noted that business sentiment, particularly that of the manufacturing sector, was deteriorating in many countries and regions, reflecting the fact that the effects of the European debt problem were spreading to the global economy as a whole through trade channels.

Members shared the recognition that economic activity in the euro area had receded slowly and would continue to do so for the time being given that fiscal austerity and severe financial conditions were likely to persist, particularly in peripheral countries. Some members noted that the effects of the continued adverse feedback loop in some peripheral countries among the fiscal situation, the financial system, and economic activity had been spreading to core countries such as Germany. These members continued that the negative effects had recently been spreading not only to the corporate sector but also to the household sector, as evidenced by the deterioration in consumer sentiment and a decline in retail sales. One member expressed the view that, taking account of this situation, economic growth in the euro area for the July-September quarter of 2012 was likely to be negative for the fourth consecutive quarter.

Members shared the view that the state of economic slowdown in China had been prolonged. Many members pointed out that this reflected not only the decline in exports to Europe, which accounted for approximately 20 percent of China's overall exports, but also the fact that inventory adjustments were taking place across broad areas, including the materials industry. As for the outlook, many members expressed the view that, although the Chinese economy was likely to gradually show clear signs of recovery, the timing and speed of such recovery were highly uncertain because they also depended on the pace of progress in inventory adjustments and the extent to which policy effects permeated the economy. Some members said that the Chinese economy could start to pick up gradually from end-2012 or after the turn of the year because, in addition to the effects of the stimulus measures, including monetary easing, adopted since around the middle of 2012, infrastructure investment projects -- amounting to 1 trillion Chinese yuan and approved in early September 2012 -- would be implemented. However, some members noted that, possibly because the stimulus measures adopted after the Lehman shock had brought about excessive capital stock and an overheating in the real estate market, recent policy measures by the Chinese authorities represented a deliberate approach compared to the measures put in place back then. A few members expressed the view that, unlike previously, it was difficult to expect a rapid recovery in economic activity within a few months following the implementation of policy measures, considering that local governments were responsible for securing most of the fiscal resources necessary for infrastructure investment, and that financial institutions, which placed importance on profitability, were taking cautious lending attitudes. Some members expressed the recognition that how the transitional phase to the new Chinese leadership would proceed and what policy stance would be presented were the key to forecasting the outlook for the Chinese economy in the near future.

Regarding the NIEs and the ASEAN countries, members concurred that the pick-up in the pace of economic growth was moderating on the whole. As factors behind this, they pointed out that exports, particularly those bound for Europe and China, had declined and production and business fixed investment had been sluggish, although private consumption had been firm. As for the outlook, some members expressed the view that the NIEs and the ASEAN countries were likely to regain the pace of economic growth on the whole. These members continued that this was because exports were likely to gradually regain their momentum in a situation where private consumption remained firm, and room for implementing further monetary easing was not limited, although business sentiment, which had become cautious -- particularly in the NIEs -- could restrain business fixed investment.

As for the U.S. economy, members agreed that it generally continued to recover at a moderate pace, and that it was likely to continue to do so, supported mainly by the accommodative financial conditions. Some members noted that signs of weakness were observed in the corporate sector, such as the slowing in the pace of increase in business fixed investment and production. Some members pointed out that, in addition to the protraction of the European debt problem, concern about the issue of the "fiscal cliff" -- a state in which fiscal spending cuts and tax increases would be implemented simultaneously at the beginning of 2013 -- was dampening business sentiment. As for the household sector, many members said that private consumption, primarily in terms of car sales, was increasing moderately and that housing investment also showed signs of a pick-up. In terms of the background to relatively firm household spending, some members pointed to the modest improvement in the employment situation, effects of monetary easing, and the wealth effects stemming from the rise in stock prices. Some members expressed the view that steady progress was being made in households' balance-sheet adjustments, and this would be a major factor in supporting the sustainability of their spending. A few members noted that, depending on households' creditworthiness, some financial institutions substantially varied their stances on extending housing loans, and said that, in forecasting developments in housing investment, it was also necessary to pay attention to the supply side -- namely, financial institutions' stance on extending loans. Some members said that attention should be paid to the possibility that the effects of the "fiscal cliff" had not been fully factored into household sentiment. Based on their discussion to this point, members shared the recognition that key factors to developments in the household sector were the pace of improvement in the employment situation, the extent to which the monetary easing permeated the economy, and treatment of the fiscal problem after the presidential election, and that it was important to carefully examine these factors.

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

Members shared the recognition that Japan's economic activity was leveling off more or less as overseas economies had moved somewhat deeper into a deceleration phase. Some members said that the results of the September *Tankan*, in which business sentiment, particularly of large manufacturers, had become somewhat cautious, were consistent with this recognition. Members agreed that exports and industrial production had been relatively weak. Many members pointed to a deterioration in the shipment-inventory balance, such as in general machinery and IT-related goods, mainly because of the weakening of exports, as well as to a growing tendency observed recently for the actual industrial production index figures to be lower than the forecast figures. On the other hand, members agreed that domestic demand had been resilient, mainly supported by reconstruction-related demand. They shared the view that public investment continued to increase with the progress in the execution of the budget related to the earthquake disaster, and that housing investment had generally been picking up. Members also shared the recognition that business fixed investment had been on a moderate increasing trend as corporate profits improved on the whole. They concurred that private consumption had been resilient with the employment situation on an improving trend on the whole, although car sales were expected to fall back following the ending of subsidies for purchasers of environmentally friendly cars. One member said that retail sales were firm on the whole and sales in the food service industry showed signs of a pick-up recently.

As for the outlook for the economy, members agreed that it was likely to level off more or less for the time being, and thereafter return to a moderate recovery path as domestic demand remained resilient and overseas economies gradually emerged from the deceleration phase. Some members said that, judging from interviews with firms and other relevant information, production was likely to remain relatively weak in the October-December quarter of 2012, reflecting the deceleration of overseas economies. As for the timing of when the economy would return to a moderate recovery path, some members expressed the view that this was likely to be delayed by about six months from the projection set out in the April 2012 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report); thus, the timing of the economy's return to a moderate recovery path would be after the start of 2013. Many members pointed out that, in a situation where public investment that had been supported by reconstruction-related demand was likely to peak out gradually, how developments in exports and production would affect business fixed investment and private consumption through developments in corporate profits and the employment situation would be an important factor in determining the outlook for the economy.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and likely to stay at this level for the time being. Many members noted that, while it was necessary to carefully examine changes in price trends, developments in the prices of petroleum products were likely to exert upward pressure on the year-on-year rate of change in the CPI for the next few months. Some members expressed the view that, given that (1) labor utilization rates might be declining recently, as seen in the decrease in the total hours worked, mainly in the manufacturing sector, and (2) the economy was likely to level off more or less for the time being, the pace of improvement in the negative output gap would be only moderate, and this would lead to a weakening of future price developments. One of these members said that the forecast presented in the April Outlook Report -- namely, that it would likely be not too long, as early as fiscal 2014, before the year-on-year rate of increase in the CPI reached 1 percent -- would be less likely to materialize. One member commented that attention needed to be paid to the effects on the CPI of the spread of a low-price strategy among major supermarkets. A different member noted that it would take a relatively long time for firms to change their price-setting behavior because, to this end, it was necessary to see a rise in firms' and households' growth expectations followed by an increase in wages and inflation expectations.

A few members pointed out that a halt to the decline in land prices was recently becoming evident in the metropolitan areas and around the disaster-stricken areas. One member, indicating that sound commercial real estate in the Tokyo area was increasingly attracting attention, commented that developments in the real estate sector should continue to be monitored carefully, as these could significantly affect sentiment in the economy as a whole.

With regard to <u>risks to the outlook for Japan's economic activity and prices</u>, 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. Many members noted that momentum toward recovery for the U.S. economy would weaken significantly if the issue of the "fiscal cliff" led to widespread negative effects, even on the U.S. household sector, through cautious sentiment and a decrease in disposable income. Many members said that, given the strong economic ties between Japan and China, the current relations between the two countries could exert downward pressure on Japan's economy through their effects on trade and investment activity between them, as well as the number of Chinese tourists to Japan, and therefore due attention needed to be paid to future developments. With regard to the fact that the effects of the stimulus measures in China remained limited, one member noted that the Chinese authorities' stance, which seemed to place importance on the stability of general prices and asset prices rather than near-term economic growth, was crucial for the Chinese economy in terms of making a successful transition to a sustainable growth path, and that this stance would contribute to the stability of the global economy in the long term. This member continued, however, that this stance could become a downside risk factor for the global economy, including Japan's economy, in the short term. Some members pointed out that, if the deceleration in overseas economies became more prolonged, this could affect domestic demand, and thus the timing of Japan's economic recovery could be further delayed. A few of these members said that, given developments in production and the Indexes of Business Conditions, the possibility could not be ruled out that the economy would be acknowledged retroactively to have entered a recessionary phase. In relation to these points, many members expressed the view that firms' attitude toward investment remained resolute, as suggested by the results of the September *Tankan*, in which business fixed investment plans continued to exhibit a relatively larger increase than those typically presented in the same period, and were revised upward from those in the June *Tankan*. Some members also pointed to the recent weakness in the aggregate supply of capital goods. One member said that these developments indicated signs of change in the resilience of domestic demand. On this basis, many members noted that, together with firms' profit forecasts, due attention should be paid to whether movements to postpone investment would spread. Some members commented that it was necessary to closely monitor whether or not developments in foreign exchange rates and stock prices would exert a negative impact on corporate profits and business sentiment in Japan. One member pointed out that, given Japan's increased dependency on liquefied natural gas (LNG) since the earthquake disaster, if the tension over the situation in the Middle East heightened further, this might exert a significant adverse impact on Japan's economic activity and prices. With regard to the outlook for prices, a different member said that, in a situation where it was taking time for short-term inflation expectations to rise, careful attention should be paid to the possibility of 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 <u>financial conditions in Japan</u> 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 and corporate bonds remained favorable on the whole while demand from investors continued to be solid. Some members expressed the view that attention should be paid to the fact that issuance spreads were widening on some CP; namely, that issued by firms for which deterioration in business performance was a matter of concern. However, these members continued that, thus far, this had not led to a situation where such a development threatened the stability of the CP market as a whole. Members -- while noting that bank lending rates remained at low levels -- shared the recognition that financial institutions' lending attitudes, as perceived by firms, and firms' financial positions continued to be on an improving trend, as suggested by the results of the September *Tankan*. Meanwhile, one member expressed the view that lending rates were approaching a "bedrock" -- the level of rates considered to be the bottom -- as the average contracted interest rates on both short- and long-term loans and discounts had been at around 1 percent, and thus were at levels below the lowest rates recorded during the period of quantitative easing. On this basis, this member commented that the degree of monetary easing should be assessed not only by gauging macroeconomic indicators such as interest rate levels, but at the same time by examining microeconomic developments, such as whether funds were actually flowing smoothly.

IV. 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.

In relation to monetary policy for the immediate future, members shared the view that Japan's economy faced the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. They continued 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. On this basis, they agreed that the Bank would continue to conduct monetary policy in an appropriate manner and do its utmost to ensure the stability of Japan's financial system while paying particular attention to developments in global financial markets. With regard to the Bank's decision at the previous meeting on September 18 and 19, 2012 to further enhance monetary easing, a few members expressed the view that the markets had likely given due recognition to the Bank's prompt response to the weaker economic activity and prices, as well as to risks to the outlook, as a standard policy action. Some members, including these members, reaffirmed their view that, in improving the transmission mechanism -- that is, ensuring that the effects of monetary policy would permeate the economy -- it was extremely important to secure confidence in the Bank's policy measures through effective communication to the public. One member said that, if the outlook for economic activity and prices deteriorated further or risks regarding the outlook became extremely high, it was necessary for the Bank to take appropriate actions, without ruling out any options in advance, by conducting a thorough examination of the effects and risks of such actions. A different member expressed the recognition that it might be necessary for the Bank to devise further ways to boost inflation expectations, such as exerting influence on foreign exchange rates.

With regard to the operation of the Program, members agreed that it was appropriate to proceed with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program, which was expanded as a result of the decision made at the previous meeting, and also to monitor its effects. Some members commented that a sufficient amount of bids continued to be submitted in the Bank's outright purchases of JGBs, supported by the Bank's decision at the previous meeting to remove the minimum bidding yield. One member noted that such firmness in bidding could also be attributable to financial institutions' need for profit taking as the end of the first half of the fiscal year approached, and therefore developments in bidding activity from October 2012 onward should be monitored as well in assessing the effects of the removal of the minimum bidding yield.

Regarding the effects of the comprehensive monetary easing measures, members discussed the transmission mechanism in which comprehensive monetary easing fed through into economic activity. They concurred that, in terms of the first stage -- namely, the effects of monetary easing permeating financial conditions -- financial conditions surrounding firms and households were accommodative. In relation to the effects of monetary easing permeating financial conditions, one member -- noting that market participants were inclined to focus on the pace of asset purchases on a flow basis -- raised the point that the market response to the Bank's decision at the previous meeting to increase the target for the amount outstanding of the Program by about 10 trillion yen might be limited in some way, as the Bank had not altered the pace of asset purchases to be implemented by end-2012. On this point, a few members expressed the view that monetary easing effects were evident mainly in the form of stock effects associated with the increase in the target for the amount outstanding of the Program, and flow effects should probably be viewed as a complement to stock effects. As for the stock effects, one of these members said that not all of them would run out immediately after the decision to expand the Program was announced; rather, the subsequent accumulation of the amount outstanding -- regardless of its pace -- to meet the increased target for the amount outstanding of the Program would also have some effects in terms of gradually boosting confidence in the Bank's policy stance.

Members next discussed the second stage of the transmission mechanism of comprehensive monetary easing -- namely, financial conditions permeating economic activity. Many members expressed the view that, despite the extremely accommodative financial conditions, this was not sufficiently leading firms to boost their investment and spending. Some members noted the importance of the government's initiative to create a more favorable environment to strengthen the economy's growth potential, in addition to firms' own efforts to explore potential demand, in order to stimulate firms' investment activity. One of these members, noting that in Japan the regions with a higher rate of population decline faced a larger decrease in banks' loan-to-deposit ratios, expressed an intent to consider whether there would be some room for devising ways to address the challenge of overcoming the adverse effects of demographic changes on economic growth, although this challenge included issues outside the scope of monetary policy. Some members expressed the opinion that, with a view to promoting the transition from the first stage to the second stage of the transmission mechanism of monetary easing, the Bank had been making contributions as the central bank through, for example, the fund-provisioning measure to support strengthening the foundations for economic growth. These members continued that it also might be necessary for the Bank to devise ways to support financial institutions' activity more directly, so that loans to firms would indeed increase.

As for the funds-supplying operation to support financial institutions in disaster areas, members, noting that the operation aimed to support financial institutions in disaster areas in their efforts to meet demand for funds for restoration and rebuilding, pointed out that the amount of loans provided by the Bank through the operation had recently been declining, in part because these institutions had relatively favorable funding conditions. They then agreed to monitor the future usage of loans under the operation.

V. Remarks by Government Representatives

The representative from the Cabinet Office made the following remarks.

(1) The government recognized that the problem of a decreasing population, which had been pointed out by one Policy Board member at this meeting, as well as a low birth rate and aging population, posed the most significant constraint on the Japanese economy. In the midst of the substantial fiscal deficit, the government -- while devising ways to allocate the budget -- had been taking measures to deal with the low birth rate and to stabilize and enhance the social security system. In the government's view, the key to promoting Japan's economic recovery was to enhance its economic strength by employing a variety of measures at full scale across a range of areas -- not only making efforts within the financial sector but also making changes to policy measures and to budget allocations, as well as implementing deregulation aimed at improving the basic strength of the economy.

(2) 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 would exert downward pressure on the Japanese economy, it was deemed necessary to monitor the situation with greater vigilance. Although the rate of decline in prices was moderating, recent price developments indicated that the Japanese economy remained in a mild deflationary situation.

(3) Under these circumstances, the third reshuffled Noda Cabinet, formed on October 1, 2012, designated the following tasks as being of high priority: overcoming deflation swiftly; realizing economic revitalization; and achieving medium- to long-term

economic growth. The government would vigorously carry out measures aimed at overcoming deflation and thereby raise Japan's growth potential.

(4) With a view to overcoming deflation swiftly, it was important that the government and the Bank deepen their dialogues and keep close contact. The government expected the Bank to make its utmost efforts in the conduct of monetary policy in parallel with the government's 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. It expected the Bank to continue with powerful monetary easing until the exit from deflation was ensured. 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, such as in the United States, Europe, and emerging economies.

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

(1) In line with the basic policy decided at the first Cabinet meeting, the third reshuffled Cabinet, formed on October 1, 2012, would continue to make every effort to realize the comprehensive reform of the social security and taxation systems and promote the "Comprehensive Strategy for the Rebirth of Japan," while recognizing that overcoming deflation swiftly was an important task in Japan.

(2) While the Japanese economy had continued to recover at a moderate pace, this recovery appeared to be pausing recently due to deceleration of the world economy. Attention should be paid to the risk that a further slowing down of overseas economies and sharp fluctuations in the financial markets, including the rapid appreciation of the yen that subsequently remained elevated, would pose downside risks to the Japanese economy. In particular, the government deemed that the recent rapid appreciation of the yen and the fact that it remained elevated posed significant downside risks to the economy.

(3) Under these circumstances, the government welcomed the Bank's additional monetary easing that was decided at the previous meeting on September 18 and 19, 2012 -- namely, to increase the total size of the Program by about 10 trillion yen -- as a timely and appropriate action. It expected the Bank to continue to carefully monitor how downside risks arising from the rapid appreciation of the yen and recent issues related

to trade, for example, would affect the Japanese economy, and to make every effort to avoid a slowdown. Furthermore, the government expected the Bank to fully communicate such efforts to the public at home and abroad.

(4) The government and the Bank shared the recognition 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 acknowledged that the Bank had been conducting monetary policy based on its 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; however, the CPI inflation rate was still below 1 percent. The government expected the Bank to continue to conduct monetary policy vigorously and decisively for the purpose of achieving the goal of 1 percent swiftly, while monitoring developments in economic activity and financial markets at home and abroad as well as working sufficiently on its communication to the public in an effort to make its policy stance fully understood.

Based on the above remarks, one Policy Board member commented that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank hoped that the current accommodative financial conditions would be fully utilized, and it was for this reason that the Bank had high expectations that the "Comprehensive Strategy for the Rebirth of Japan," which was formulated by the government in July, would be realized steadily. This member added that the Bank would continue to effectively fulfill its mission to ensure the overcoming of deflation and the return of Japan's economy to a sustainable growth path with price stability, while closely exchanging views with the government.

VI. Votes

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.

VII. Discussion on the Statement on Monetary Policy

Members discussed the Statement on Monetary Policy, and it was 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).

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of September 18 and 19, 2012 for release on October 11, 2012.

Attachment

October 5, 2012

Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan 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.

2. Overseas economies have moved somewhat deeper into a deceleration phase. In global financial markets, while investors have remained somewhat less risk averse on the back of the European debt problem, particular attention should be given to developments in these markets.

3. Japan's economic activity is leveling off more or less. Exports and industrial production have been relatively weak as overseas economies have moved somewhat deeper into the deceleration phase. On the other hand, domestic demand has been resilient, mainly supported by reconstruction-related demand. Specifically, public investment has continued to increase, and housing investment has generally been picking up. Private consumption has been resilient with the employment situation on an improving trend. Business fixed investment has been on a moderate increasing trend as corporate profits have improved on the whole. As for business sentiment, firms have turned somewhat cautious mainly against the background of the deceleration in overseas economies. Financial conditions in Japan are accommodative. On the price front, the year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent.

4. With regard to the outlook, Japan's economy is expected to level off more or less for the time being, and thereafter, it will return to a moderate recovery path as domestic demand remains resilient and overseas economies gradually emerge from the deceleration phase. The year-on-year rate of change in the CPI is expected to remain at around 0 percent for the time being.

5. 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.

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.