Not to be released until 8:50 a.m. Japan Standard Time on Wednesday, December 26, 2012.

December 26, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on November 19 and 20, 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 Monday, November 19, 2012, from 2:00 p.m. to 4:38 p.m., and on Tuesday, November 20, from 9:00 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)[6]

---

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on December 19 and 20, 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 November 20.

[3] Mr. S. Sato was present on November 19.

[4] Mr. S. Maehara was present on November 20 from 11:05 a.m. to 12:09 p.m.

[5] Mr. K. Matsuyama was present on November 19 for the whole of the session, and on November 20 from 9:00 a.m. to 11:03 p.m.

[6] Mr. H. Nakaso was present on November 20.

Mr. H. Hayakawa, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director

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

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

Mr. S. Aoki, Director-General, Financial Markets Department

Mr. E. Maeda, Director-General, Research and Statistics Department

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. A. Okuno, Senior Economist, Monetary Affairs Department

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

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 October 30, 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 had recently been active bidding in the Bank's fixed-rate funds-supplying operation against pooled collateral as advanced fund-raising had been observed in view of the decrease in the amount outstanding of the operation toward end-2012, while a seasonal shortage of funds at financial institutions had occurred due to tax payments and the issuance of Japanese government bonds (JGBs). As for the Bank's outright purchases of both JGBs and treasury discount bills (T-Bills), the amount outstanding of these assets had steadily accumulated in a situation where a sufficient amount of bids continued to be observed.

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 declined very slightly.

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 continued to hover within the range of 0.75-0.80 percent, but had recently fallen to 0.70-0.75 percent, in line with the decline in U.S. interest rates, in an environment where uncertainty associated with the "fiscal cliff" was drawing attention again after the presidential and Congressional elections in the United States. The Nikkei 225 Stock Average temporarily declined to some extent in response to the drop in U.S. stock prices and Japanese firms' somewhat weaker-than-expected corporate results for the July-September quarter of 2012, but had

---

[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.

recently recovered to the 9,000 yen level, mainly reflecting depreciation of the yen. Prices for Japan real estate investment trusts (J-REITs) had recently recovered after declining somewhat. Yield spreads between corporate bonds and JGBs, although widening in the case of some corporate bonds, mainly due to deterioration in business performance, were more or less unchanged on the whole, reflecting continued solid demand from investors for corporate bonds. The yen temporarily appreciated against the U.S. dollar in response to the decline in U.S. interest rates following the presidential and Congressional elections in the United States, but had recently depreciated to the 81-82 yen range.

C. Overseas Economic and Financial Developments

Overseas economies remained in a deceleration phase.

The U.S. economy generally continued to recover at a moderate pace, particularly in the household sector, although signs of weakness were observed in the corporate sector. The pace of increase in production and business fixed investment had slowed as growth in exports had been sluggish and business sentiment had become cautious. 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 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, had been more or less flat.

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 sluggish. Given such developments in demand, production was on a declining trend, and the real GDP growth rate for the July-September quarter of 2012 had been negative for four consecutive quarters. 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 had been more or less flat, due in part to 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. While private consumption had been firm on the whole, some weakness was observed in car sales due to a plunge in sales of Japanese automobiles. The slowdown in the pace of increase in fixed asset investment was coming to a halt due to an increase in infrastructure investment. Meanwhile, exports continued to be relatively weak, reflecting the decrease in those bound for Europe. Given such developments in demand, the growth momentum in production continued to be slow as inventory adjustment pressures persisted. Regarding the NIEs and the ASEAN countries, although these economies had picked up, the pace was moderating, particularly in the corporate sector. Exports and production continued to be relatively weak, mainly due to the decline in exports bound for Europe, 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 some 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' 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 for 10-year government bonds issued by European countries over German government bonds had been relatively tight, but widened somewhat recently, particularly in peripheral countries, mainly due to uncertainty regarding bailout loans to Greece provided by the European Union (EU) and the International Monetary Fund (IMF). U.S. and European stock prices had been declining, due in part to weak corporate results in an environment where uncertainty associated with the fiscal cliff was drawing attention again following the presidential and Congressional elections in the United States. In this situation, long-term interest rates in the United States and Germany were declining marginally. With regard to corporate bond markets in the United States and Europe, credit spreads had been more or less unchanged. 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 more or less flat at a low level. Spreads between interest rates on U.S. dollar-denominated term instruments and OIS rates, as well as the U.S. dollar funding premium in the foreign exchange swap markets, had been more or less unchanged at low levels. Meanwhile, stock prices and currencies in emerging and commodity-exporting economies had been essentially unchanged, albeit with some fluctuations.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports and industrial production had decreased, mainly due to the fact that overseas economies remained in 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-September quarter. Industrial production kept decreasing in the April-June and July-September quarters on a quarter-on-quarter basis, after having increased in the January-March quarter. The production forecast index recently showed that a downtrend had become evident, with larger downward revisions in both the realization and amendment ratios. Exports and industrial production were expected to continue decreasing for the time being and start picking up thereafter as overseas economies gradually emerged from the deceleration phase. Judging from interviews with firms and other relevant information, industrial production for the October-December quarter was expected to continue moving downward, mainly in that of transport equipment and general machinery. For the January-March quarter of 2013, although there was still a high degree of uncertainty, it seemed likely that production would become more or less flat as a whole.

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 -- had risen for four straight quarters since the October-December quarter of 2011. The value of public works contracted -- a measure that reflected public works orders -- was up again in October relative to the July-September quarter, after having been flat in that quarter following an upsurge in the April-June quarter. Public investment was expected to continue increasing for the time being, albeit at a slower pace.

Business fixed investment had shown some weakness in the manufacturing sector, mainly due to the effects of the deceleration in overseas economies, although it remained on a moderate increasing trend. Although construction starts in terms of floor area continued to increase and machinery orders from nonmanufacturing firms remained solid, the aggregate supply of capital goods declined rather sharply and machinery orders from manufacturers were relatively weak. Business fixed investment was projected to continue a moderate increasing trend -- although it would be impacted for the time being mainly by the deceleration in overseas economies -- partly due to investment related to disaster prevention and energy, as corporate profits maintained their improving trend on the whole.

The employment and income situation remained severe and the improvement in supply and demand conditions in the labor market had come to a halt, notably in the manufacturing sector, as seen in developments in the number of job openings and in non-scheduled hours worked.

Private consumption remained resilient, but car sales had recently fallen back due to the ending of some measures to stimulate demand for automobiles. Private consumption was expected to remain resilient as a trend, although it would show some weakness for the time being, mainly since car sales had fallen back.

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, the pick-up in international commodity prices had paused. The domestic corporate goods price index (CGPI) had stopped declining in terms of the three-month rate of change, reflecting earlier movements in international commodity prices. The CGPI was expected to be more or less flat for the time being. 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 demand from investors continued to be solid, although some firms inevitably faced difficulty in issuing corporate bonds and were experiencing a widening of issuance spreads on CP, mainly due to deterioration in business performance. 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 change in the amount outstanding of bank lending had been positive. That of CP had also been positive. In contrast, the year-on-year rate of change in the amount outstanding of corporate bonds, especially electric power company bonds, had been negative. In these circumstances, firms retained their recovered financial positions on the whole. The year-on-year rate of change in the money stock had been positive, within the range of 2-3 percent. Meanwhile, the medium- to long-term inflation expectations of economists and market participants had recently been declining moderately.

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. Many members expressed the view that, due in part to the various measures being implemented by the European authorities, including the new modalities for undertaking Outright Monetary Transactions (OMTs) introduced by the European Central Bank (ECB), the tail risk of serious disturbances in global financial markets arising from the European debt problem had waned somewhat. On this basis, these members noted that a high degree of uncertainty remained in the markets, particularly regarding (1) future developments in bailout loans to Greece provided by the EU and the IMF, (2) whether or not Spain would ask for a full-scale financial bailout from other euro area countries, and (3) progress toward establishing a single banking supervisory mechanism in the euro area. With regard to the declines in U.S. and European stock prices, most members expressed the view that these reflected growing concerns over the fiscal cliff following the presidential and Congressional elections in the

United States. A few members added that, in addition to the issue of the fiscal cliff in the United States, the future course of the debt-ceiling negotiations in the U.S. Congress warranted attention as a risk factor for the financial markets.

Members concurred that overseas economies as a whole remained in a deceleration phase as the European economy had not yet stopped deteriorating, although some positive developments had been observed in parts of the U.S. and Chinese economies. As for the outlook, they shared the recognition that overseas economies were likely to remain in the deceleration phase for the time being but would gradually emerge from that phase and turn to a moderate recovery thereafter, on the assumption that global financial markets would remain stable on the whole.

Members shared the recognition that economic activity in the euro area had receded slowly. Many members pointed out that the adverse feedback loop in some peripheral countries among the fiscal situation, the financial system, and economic activity had continued, and its negative effects were growing further, even in core countries such as Germany. Meanwhile, one member said that there appeared to be some resilience in the German economy, as seen in the fact that the unemployment rate remained at a historically low level and real estate rents in urban areas were increasing. As for the outlook, members shared the view that the euro area economy would likely still lack momentum for recovery on the whole as fiscal austerity measures continued to be implemented in peripheral countries, although core countries were likely to post higher growth gradually due to an increase in exports to outside the area.

Members shared the view that the state of economic slowdown in China had been prolonged, mainly reflecting the decline in exports to Europe, which accounted for approximately 20 percent of China's overall exports, and persisting inventory adjustment pressures in a wide range of industries, including materials industries. On this basis, many members pointed out that some parts of the economy exhibited signs that its deceleration phase was coming to an end, as seen in the fact that (1) fixed asset investment, including infrastructure investment, and retail sales had recently increased at a faster pace due to the materialization of positive effects of economic stimulus measures on both the monetary and fiscal fronts adopted since May 2012; and (2) the Purchasing Managers' Index (PMI) for manufacturing activity for October 2012 had recovered to the 50-point level. As for the outlook, many members expressed the view that the timing and pace of economic recovery in China continued to be highly uncertain given, for example, that growth in exports -- mainly those bound for Europe -- was expected to remain relatively low for the time being. However, these members added that the economy would register higher growth gradually as the positive effects of such policy measures as monetary easing and the bringing forward of future infrastructure investment plans started to appear and inventory adjustments progressed.

Regarding the NIEs and the ASEAN countries, members concurred that the pace of the pick-up in these economies had moderated, particularly in the corporate sector, as exports and production continued to be relatively weak and growth in business fixed investment had been sluggish, although private consumption had been firm. As for the outlook, some members expressed the view that the pace of recovery in these economies was likely to increase on the whole, with private consumption remaining firm and exports picking up gradually, although cautious business sentiment -- which had prevailed particularly in the NIEs -- was likely to restrain business fixed investment, mainly in the manufacturing sector.

Members shared the recognition that the U.S. economy generally continued to recover at a moderate pace, particularly in the household sector, although signs of weakness were observed in the corporate sector. Many members noted that weakness continued to be observed in the corporate sector, such as the sluggish growth in exports and the slowdown in the pace of increase in production, particularly in the manufacturing sector. Some members pointed out that the pace of increase in business fixed investment had slowed and new orders for nondefense capital goods, a leading indicator of business fixed investment, remained relatively weak, as business sentiment had become cautious on the back of uncertainties associated with the fiscal cliff and the outlook for the global economy. As for the household sector, many members expressed the view that private consumption, including car sales, was increasing moderately, reflecting the continued improvement in the employment situation, and that housing investment had also continued to pick up, albeit at a depressed level, partly supported by the low interest rate. As for the outlook, members concurred that the U.S. economy was likely to continue recovering at a moderate pace, supported by accommodative financial conditions. With regard to the effects of Hurricane Sandy, which struck the northeastern United States at the end of October 2012, a few members expressed the view that, although it had caused greater damage than initially expected, its impact on the macroeconomy was likely to be temporary and small. These members continued that, even taking into account future demand for reconstruction, the effects of the hurricane would not result in changes to the baseline scenario that the U.S. economy would continue recovering at a moderate pace. One member commented that it was highly likely that, as banks' residential real estate lending standards gradually normalized, a recovery trend in housing investment would become clearer and thereby underpin the U.S. economic recovery. A different member identified the following developments as recent concerns over the U.S. economy: (1) the pace of increase in the S&P/Case-Shiller Home Price Indices had been slowing somewhat since summer 2012; (2) the number of job openings, a leading indicator for the number of employees, had exhibited signs of a pause in its recovery trend; and (3) stock prices, which influenced business and household sentiment, had been sluggish. This member noted that it was therefore necessary to carefully examine whether the momentum of economic recovery in the United States would weaken.

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

Members shared the recognition that the economy had been weakening somewhat. With regard to the recent weakness, many members pointed to the effects of (1) the deceleration in overseas economies, (2) recent developments in the relations between Japan and China, and (3) the ending of subsidies for purchasers of environmentally friendly cars. Members agreed that exports and industrial production had decreased, mainly due to the fact that overseas economies remained in a deceleration phase. They concurred that, although business fixed investment remained on a moderate increasing trend, it had shown some weakness in the manufacturing sector, mainly due to the effects of the deceleration in overseas economies. In relation to the fact that real business fixed investment had decreased significantly in the first preliminary estimates of GDP statistics for the July-September quarter of 2012, many members said that business sentiment was deteriorating and therefore it was necessary to carefully examine whether there was any change to the underlying trend of business fixed investment. At the same time, these members referred to the following developments. First, construction starts in terms of floor area continued to increase, particularly those for nonmanufacturing firms. Second, machinery order figures -- including the forecast for the October-December quarter of 2012

-- received from nonmanufacturing firms (excluding orders for ships and those from electric power companies) remained solid. Third, investment related to disaster prevention and energy, which was unlikely to be affected by economic developments, continued to be firm. And fourth, business fixed investment was still at a low level, although recovery had progressed from the plunge that had occurred following the Lehman shock, and there was a natural limit to how long firms could postpone investment for maintenance and replacement. These members continued that it was therefore necessary to assess the underlying trend of business fixed investment after examining forthcoming data, such as the results of the *Financial Statements Statistics of Corporations by Industry, Quarterly* to be released in December 2012, the second preliminary estimates of GDP statistics for the July-September quarter, and business fixed investment plans in the December 2012 *Tankan* (Short-Term Economic Survey of Enterprises in Japan). Members agreed that private consumption remained resilient, but car sales had recently fallen back due to the ending of some measures to stimulate demand for automobiles. A few members commented that indicators of consumer confidence, while maintaining their moderate improving trend, had recently ceased to show improvement. Many members expressed the view that the employment and income situation remained severe and the improvement in supply and demand conditions in the labor market had come to a halt, notably in the manufacturing sector, as seen in developments in the number of job openings and in hours worked.

With regard to the aforementioned developments in economic activity, many members commented that domestic demand was beginning to be adversely affected -- starting with the decrease in exports and industrial production -- through channels such as (1) a deterioration in corporate profits and a decline in capacity utilization; (2) postponement of fixed investment, particularly by manufacturers; and (3) downward pressure on labor income. These members continued that this was evidenced by the first preliminary estimate of real GDP for the July-September quarter of 2012, which showed significant negative growth. A few members expressed the view that it was likely that Japan's economy had been in recession since spring 2012, and the key issues for the economy had shifted to the depth and duration of the recession. These members said that they were paying attention to developments in business fixed investment on the basis of such a perspective. Members shared the view 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, supported in part by reconstruction of disaster-stricken homes.

As for the outlook for the economy, members agreed that it was likely to remain relatively weak for the time being and thereafter return to a moderate recovery path, as domestic demand remained resilient on the whole and overseas economies gradually emerged from the deceleration phase. While noting that the Bank's baseline scenario described in the October 2012 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) would be maintained, members concurred that -- judging in part from anecdotal information obtained since the release of the Outlook Report -- both exports and industrial production were likely to continue decreasing for the time being, and it appeared likely that the economy as a whole would remain relatively weak, rather than more or less level off. In relation to this, many members pointed to the effects of recent developments in the relations between Japan and China. One member -- noting that a recovery in exports was important in terms of the mechanism for economic recovery -- commented that it was difficult to expect a clear recovery path because, unlike in past similar phases, the momentum toward recovery for overseas economies was fragile and a depreciation of foreign exchange rates caused by a widening in interest rate differentials between Japan and other economies could not be expected in the current phase. A few members said that the timing of the economy's move toward a recovery would likely be around the mid-2013, although it depended on when overseas economies would emerge from the deceleration phase. A different member expressed the view that, even if exports and production were to emerge from their declining phase by the April-June quarter of 2013, the timing of economic recovery might be delayed to the latter half of 2013.

Regarding prices, members shared the recognition that the CGPI, in terms of the three-month rate of change, had stopped declining, reflecting the earlier movements in international commodity prices, and was likely to be more or less flat for the time being. They 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. Some members noted that attention needed to be paid to the effects on price developments of the decline in the level of resource utilization among manufacturers and the increasing adoption of a low-price strategy by major supermarkets. One member added that, in considering the outlook for prices, an improvement in the supply and demand balance in the labor market was crucial. However, this member continued that, mainly because of developments in wages, a cautious view regarding the outlook for prices was inevitable.

With regard to risks to the outlook for Japan's economic activity and prices, members concurred that there remained a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, the possibility of emerging and commodity-exporting economies making a smooth transition to the sustainable growth path, and the spreading effects of recent developments in the relations between Japan and China. They continued that, furthermore, attention should continue to be paid to the effects of financial and foreign exchange market developments on economic activity and prices. Members shared the concern that, if negotiations between the president of the United States and Congress on the fiscal cliff did not produce a favorable outcome, and the expiration of temporary tax cuts and benefits occurred and automatic spending reductions were carried out for the most part, this could exert significant downward pressure on the U.S. economy through declines in disposable income and public demand. A few members noted that the risk of the fiscal cliff stalling the economy did not seem to have been fully factored into household sentiment. One of these members added that, if the fiscal cliff could be avoided, thereby mitigating uncertainty surrounding the future course of fiscal policy, pent-up demand would likely materialize from 2013 onward with regard to business fixed investment that firms had postponed so far. Meanwhile, a few members commented that the quantitative effects of the fiscal cliff on GDP were highly uncertain because these depended not only on the details of tax increases and fiscal spending cuts, but also on the size of their multiplier effects. As a medium- to long-term risk factor to the Chinese economy, some members pointed to the issue of whether it would manage to succeed in making the transition from a high-growth phase to a sustainable stable growth phase by overcoming the problem of excess capacity.

Members agreed that there was concern that, if the deceleration in overseas economies became more prolonged, the pick-up in exports and industrial production would be delayed, thereby intensifying the negative effects on domestic demand. One member expressed concern that, although signs of a pick-up had recently been seen in electronic parts and related sectors, if a global deceleration in the manufacturing sector was protracted and firms' stance of restraining business fixed investment continued, exports and production of capital goods and parts -- which accounted for a large proportion of the Japanese industry

-- might continue to decline. Many members noted that it was also necessary to pay attention to the risk that, even if overseas economies emerged from the deceleration phase, this would not directly lead to a pick-up in exports and industrial production, mainly because of the possibilities that the effects of recent developments in the relations between Japan and China would remain and that the international competitiveness of Japanese exporting firms, on both the price and non-price fronts, was declining. With regard to the outlook for prices, some members -- noting that the medium- to long-term inflation expectations of economists and market participants had recently been declining moderately -- said that due attention needed to be paid to whether such developments would exert downward pressure on actual wages and prices by spreading to households' and firms' inflation expectations. Meanwhile, one member commented that it was necessary to continue to closely monitor the various problems regarding Japan's fiscal sustainability, as well as the market's perception.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative.

Members agreed that money market rates, including interest rates on term instruments, had been extremely stable, as the Bank had been pursuing powerful monetary easing and the soundness of financial institutions' balance sheets had been maintained. While noting that bank lending rates remained at low levels, they shared the recognition that indicators related to financial institutions' lending attitudes as perceived by firms as well as to the financial positions of firms, remained at improved levels -- exceeding the average for the period since 2000. Members shared the view that issuing conditions for CP and corporate bonds remained favorable on the whole, as demand from investors continued to be solid. On this basis, many members said that some firms inevitably faced difficulty in issuing corporate bonds and were experiencing a widening of issuance spreads on CP, mainly due to deterioration in business performance. These members continued that, since the number of such firms seemed to be increasing gradually, careful attention should be paid to future developments. Some of these members added that particular attention should be paid to whether financial positions were worsening for small firms -- for example, those in *keiretsu* relationships with firms that were experiencing a deterioration in business performance.

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.

In relation to monetary policy for the immediate future, members acknowledged that Japan's economy faced the critical challenge of overcoming deflation as early as possible and returning to the sustainable growth path with price stability. They then shared the recognition that this challenge would be met through the combination of efforts by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side. Based on such recognition, members agreed that, while the Bank would provide support for financial institutions' efforts to strengthen the foundations for economic growth and to increase their lending, it would pursue aggressive monetary easing in a continuous manner by conducting its virtually zero interest rate policy as well as steadily increasing the amount outstanding of the Program. On this basis, they shared the view that the Bank continued to conduct monetary policy in an appropriate manner and would do its utmost to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets. With regard to the Bank's decision at the previous meeting on October 30, 2012 to further enhance monetary easing, members shared the recognition that its decisive response to the weaker outlook for economic activity and prices, as well as to risks to the outlook, seemed to be regarded as an orthodox policy action. On this basis, some members reaffirmed their view that, in improving the transmission mechanism, it was extremely important to secure confidence in the Bank's policy through the continuation of appropriate communication to the public.

Some members said that, if the outlook for economic activity and prices deteriorated further or risks regarding the outlook increased substantially, it was necessary for the Bank to take appropriate actions decisively, by examining the effects and risks of any actions in a thorough manner without ruling out particular options in advance.

Some members raised the point that it might be necessary for the Bank to improve its policy measures further to enhance the influence of monetary policy on foreign exchange rates. A few of these members expressed the recognition that misunderstanding and suspicions about the Bank's monetary easing stance existed in, for example, the foreign exchange market. In view of the need to dispel such misunderstanding and suspicions, thereby encouraging further permeation of monetary easing effects, as well as to influence market expectations, these members then raised the issue, as in the previous meeting, of whether it would be effective to change the current wording of the Bank's policy commitment -- namely, that the Bank aimed to achieve its goal of 1 percent for the time being in terms of the year-on-year rate of increase in the CPI through the pursuit of powerful monetary easing, conducting its virtually zero interest rate policy and implementing the Program mainly through the purchase of financial assets, and would continue with this powerful easing until it judged the 1 percent goal to be in sight. One of these members said that an option for the Bank would be to clearly present in the statement, which was to be released immediately after the meeting, that it would continue powerful monetary easing mainly through the virtually zero interest rate policy and the purchase of financial assets, without setting any timeframe, until it achieved a CPI inflation rate of 1 percent. In response, many members pointed out that, if such misunderstanding and suspicions about the Bank's monetary easing stance did indeed exist, these should be dispelled by the Bank's in-depth explanation. A few of these members expressed the view that, given that the yield curve was stable at a very low level at present, a change in the wording of the policy commitment would hardly have a material effect in terms of further lowering longer-term interest rates, and in this regard the Bank's monetary easing stance could be considered to have thoroughly permeated financial markets. A different member commented that a decline in long-term interest rates could be ascribed to an extension in the expected duration of the virtually zero interest rate as a result of either of the following: (1) the Bank's policy commitment or (2) a deterioration in the outlook for economic activity and prices. This member continued that it was difficult to clearly distinguish between the two, and thus careful discussion was warranted. One member -- noting that the shorter-end government bond yields in some countries with high creditworthiness were in negative territory -- said that, although the abolishment of the payment of interest on excess reserve balances at the Bank would pose various problems, such as a decline in the functioning of financial markets, if such abolishment could bring down yields further on

T-Bills in Japan, this might reduce the attractiveness of the yen as a safe-haven currency and exert influence on foreign exchange rates. On this point, a different member commented that another measure to encourage a decline in yields on T-Bills would be to increase the Bank's outright purchases of T-Bills while continuing with the payment of interest on excess reserve balances. One member raised the issue of how to understand the background behind the fact that a full-fledged recovery had not materialized in major developed economies, including Japan, despite their extremely aggressive monetary easing. As the background, this member pointed to the following: (1) while the U.S. and European economies were in the process of balance-sheet adjustments, just like Japan's economy during the post-bubble period, economic entities burdened with excess debts were becoming less sensitive to interest rates; and (2) the effects of low interest rates -- namely, increasing aggregate demand by bringing forward future spending to the present -- would gradually diminish as the low interest rate period became prolonged.

With regard to the operation of the Program, members agreed that it was appropriate to steadily increase the amount outstanding of the Program, which had expanded by about 21 trillion yen as a result of the decisions to enhance monetary easing made over two consecutive months, and also to monitor its effects. As for the effects on financial markets of the increase in the total size of the Program decided at the previous meeting, one member noted that (1) yields on government securities, particularly those with longer maturities, had been declining further; (2) 3-month TIBOR had also been declining, albeit slightly; and (3) some market participants viewed the increase in purchases of risk assets as having contributed to alleviating concerns about a further slide in prices of these assets. A different member commented that, as the cumulative effects of monetary easing strengthened, the supply and demand balance of sound commercial real estate properties in the Tokyo area was tightening.

Regarding the fund-provisioning measure to stimulate bank lending (hereafter the Stimulating Bank Lending Facility), members reaffirmed their view that the purpose of establishing the facility was to create a situation in which accommodative financial conditions that had already been attained would be actively utilized, and therefore the Bank should decide the specifics of the facility at the next meeting, announce them immediately after the meeting, and begin its operation as early as possible. Noting that the staff was currently firming up the operational details of the facility while taking into account the opinions of financial institutions, members also agreed that it was necessary to make the facility as easy as possible for financial institutions to use, with a view to promoting their more aggressive action and helping increase the proactive credit demand of firms and households. One member added that some cases of overseas central banks might be instructive in terms of providing incentives for financial institutions. A few members pointed out that some in the markets and in the financial communities raised questions regarding the effects of the Stimulating Bank Lending Facility and expressed concern that the facility might intensify competition among financial institutions to lower lending rates, against the background of sluggish demand for funds and slow growth in lending. In response, some members said that the sluggish demand for funds -- despite the extremely accommodative financial conditions in Japan, both in terms of interest rates and availability of funds -- was the primary reason behind the need to create a situation in which firms and households would actively utilize such conditions. These members noted that, in enhancing the transmission mechanism of monetary easing, it was extremely important that not only the Bank but also financial institutions, which had long-standing business relationships with firms and households, provide support from the financial side. These members added that financial institutions' efforts to increase lending would lead to strengthening of their own profit bases over the medium to long term, and therefore were roughly consistent with the goal at which these institutions should aim.

IV. Remarks by Government Representatives

The representative from the Cabinet Office made the following remarks.

(1) Correction of the yen's appreciating trend and the overcoming of deflation were critical challenges for the Japanese economy; however, monetary easing alone would not lead to the resolution of these challenges, and it was necessary to improve the fundamental structure of the economy. Furthermore, the Bank's independence should be respected. The government and the Bank had released the "Measures Aimed at Overcoming Deflation" on October 30, 2012. It was extremely important that, for the first time, the government and the Bank had jointly announced that they would work together and make their utmost efforts toward overcoming deflation as early as possible. It was necessary for them to cooperate with each other in order to correct the yen's appreciating trend.

(2) The economic situation was increasingly severe, and it was necessary for the government and the Bank to work together and make their utmost efforts to address concerns over a possible further worsening of economic developments. Although signs of the yen's depreciation had been observed since the end of the previous week, future developments warranted attention.

(3) The government was currently formulating economic policy measures that would produce an immediate impact and stimulate demand, with a view to overcoming deflation and realizing economic revitalization. On November 30, 2012, it would decide a package for the release of contingency funds for the second round of the measures and other economic policy measures in view of the supplementary budget. In order to reform an economic structure that was predisposed to deflation, the government was promoting the "Comprehensive Strategy for the Rebirth of Japan" and working to strengthen the economy's growth potential in such areas as the environment and energy as well as medical and nursing care. It would continue to further its efforts toward overcoming deflation as early as possible.

(4) The government strongly expected the Bank to continue with powerful monetary easing until the exit from deflation was ensured. It was 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 -- and the government expected the Bank to have discussions while laying out a wide range of policy options on the table for consideration. At the previous meeting on October 30, the Bank decided to establish the Stimulating Bank Lending Facility. The government expected the Bank to draw up concrete plans as early as possible, before end-2012, and make the facility easy to use, in order to generate significant monetary easing effects.

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

(1) On October 30, the government and the Bank released the "Measures Aimed at Overcoming Deflation," or the "shared understanding" between the two entities. At the Ministerial Council on Exiting Deflation held on November 12, it was confirmed that they would have in-depth discussions aimed at overcoming deflation as early as possible, in accordance with the "shared understanding."

(2) On November 16, the government obtained the Diet's approval of the bill on special provisions concerning the issuance of government bonds. The government lifted the limits on the execution of budgets on the same day and would work on such execution in a smooth and prompt manner.

(3) In the November 2012 issue of the *Monthly Economic Report*, the government revised downward its assessment of the state of the Japanese economy for the fourth consecutive month. As for the outlook, uncertainty about the prospects for overseas economies remained high, and a further slowing down of overseas economies and sharp fluctuations in the financial markets were downside risks to the Japanese economy. Under these circumstances, the Prime Minister had recently instructed that a second round of the economic policy measures be decided on November 30. The government would implement policy measures to overcome deflation in a seamless manner.

(4) The government expected the Bank to continue to carefully monitor downside risks, such as the effects of the yen's appreciation and of recent developments in the relations between Japan and China, and to make every effort to address these risks. Furthermore, it expected the Bank to fully communicate such efforts to the public at home and abroad. In the "shared understanding," the government and the Bank confirmed that overcoming deflation as early as possible was a common challenge, and the Bank made clear its stance that, for the purpose of addressing this challenge, it would pursue powerful monetary easing with the aim of achieving the goal of 1 percent for the time being 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, this goal was not yet in sight. The government deemed it important for the Bank to indicate clearly that it was determined to pursue powerful monetary easing in a continuous manner, in order to achieve the goal of 1 percent as early as possible in accordance with the "shared understanding." Therefore, it expected the Bank to continue to conduct monetary policy vigorously and decisively. Regarding the framework of the Stimulating Bank Lending Facility, its establishment had been decided at the previous meeting, and the government expected that the facility would stimulate firms' and households' investment and consumption, thereby contributing to improvement in economic activity and prices. The government therefore expected the Bank to work on formulating the specifics of the facility and to begin its operation as early as possible.

V. 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.

VI. 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).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of October 30, 2012 for release on November 26, 2012.

Attachment

November 20, 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 remain in 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.

3. Japan's economy has been weakening somewhat. Exports and industrial production have decreased mainly due to the aforementioned development in overseas economies. Business fixed investment has shown some weakness in manufacturing mainly due to the effects of the deceleration in overseas economies, while it has been on a moderate increasing trend. In private consumption, car sales have recently fallen back due to the ending of some measures to stimulate demand for automobiles, while it has remained resilient. Meanwhile, public investment has continued to increase, and housing investment has generally been picking up. 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 remain relatively weak for the time being, and thereafter, it will return to a moderate recovery path as domestic

demand remains resilient on the whole 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 concerning Japan's economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, the possibility of emerging and commodity-exporting economies making a smooth transition to the sustainable growth path, and the spreading effects of the recent bilateral relationship between Japan and China. Furthermore, attention should continue to 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 as early as possible and returning to the sustainable growth path with price stability. This challenge will be met through the combination of 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, while the Bank will provide support for financial institutions' efforts to strengthen the foundations for economic growth and to increase their lending, it will pursue aggressive monetary easing in a continuous manner by conducting its virtually zero interest rate policy as well as 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.