

The Bank's Business Operations

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I. MONETARY POLICY

The Bank of Japan decides and implements monetary policy, with the aim of achieving price stability and thereby contributing to the sound development of the national economy, as stipulated in Article 2 of the Bank of Japan Act (hereafter the Act). Monetary policy is decided by the Policy Board at Monetary Policy Meetings (MPMs), and money market operations—the Bank's day-to-day provision and absorption of funds in the market—are carried out based on the guideline decided at each MPM. The Bank held 14 MPMs in fiscal 2007.

The Policy Board members' assessment of the economic and financial situation is expressed in "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments*. The text of "The Bank's View" section is decided by the Policy Board at the first MPM of each month and released the same day. The Bank also releases semiannually, in April and October, the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), after the Policy Board has decided the text of "The Bank's View" section at the second MPM of the month. In the Outlook Report, taking into account the "understanding of medium- to long-term

price stability,"¹ the Bank presents its outlook for developments in economic activity and prices for the next one to two years, assesses upside and downside risks, and outlines its views on the future course of monetary policy. Furthermore, the Bank makes interim assessments of the outlook laid out in the Outlook Report semiannually at MPMs in January and July. The interim assessments are included in "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments*.^{2,3}

The Bank, pursuant to Article 54, paragraph 1 of the Act, prepares the *Semiannual Report on Currency and Monetary Control* approximately every six months, covering matters related to the conduct of monetary policy (those listed in the items of Article 15, paragraph 1 of the Act) and conditions of business operations that the Bank has conducted based thereon, and submits it to the Diet through the Minister of Finance. In the most recent two issues of this report, the Bank explains in detail the economic and financial developments as well as the Bank's conduct of monetary policy and money market operations during fiscal 2007.⁴

II. FINANCIAL SYSTEM POLICY

One of the core purposes of the Bank, as stipulated in Article 1, paragraph 2 of the Act, is to "ensure smooth settlement of funds among banks and other financial

institutions, thereby contributing to the maintenance of stability of the financial system." To this end, the Bank provides safe and convenient settlement assets in the

1. The "understanding of medium- to long-term price stability" is the level of inflation that each Policy Board member understands, when conducting monetary policy, as being consistent with price stability over the medium to long term, and is, in principle, reviewed annually.

2. On July 15, 2008, the Bank decided to enhance its communication strategy in line with its "Framework for the Conduct of Monetary Policy" introduced in March 2006. For details, see "Further Enhancement of Communication Strategy under the 'Framework for the Conduct of Monetary Policy.'"

3. The text of these publications is available at the Bank's web site (<http://www.boj.or.jp/en/index.htm>).

4. The full texts in Japanese and the summary in English are available at the Bank's web site.

form of deposits in financial institutions' current accounts held at the Bank, and takes measures to enhance the safety and efficiency of the payment and settlement systems. The Bank also takes various measures to prevent systemic risk from materializing, that is, to ensure that a financial institution's inability to complete settlement of a transaction does not result in a chain of settlement failures at other institutions and thus disrupt the overall functioning of the financial system.

Specifically, the Bank may provide financial institutions suffering a shortage of liquidity with the following: (1) loans against collateral in the form of securities, pursuant to Article 33; and/or (2) other forms of liquidity, in its role as the lender of last resort, pursuant to Articles 37 and 38 of the Act. In order to be ready to act as the lender of last resort, the Bank strives to gain an accurate grasp of the financial conditions at financial institutions and to encourage the maintenance of sound financial conditions through the conduct of on-site examinations (examinations which the Bank carries out by visiting the premises of financial institutions pursuant to Article 44 of the Act) as well as off-site monitoring (monitoring which is conducted through meetings and telephone interviews with officers and employees of financial institutions, as well as through analysis of various documents submitted by these institutions) (Tables 1 and 2).

Moreover, the Bank takes part in initiatives to ensure the sustained stability of the financial system with relevant parties by publishing the results of research activity on the financial system in various forms—for example, the *Financial System Report*. Through

activities such as seminars and workshops organized by the Bank's Center for Advanced Financial Technology (CAFT), the Bank encourages financial institutions' efforts to enhance their management of risks and business activities. The Bank has also been participating in international initiatives to maintain the stability of the global financial system. One of these initiatives is its participation in discussions held by the Basel Committee on Banking Supervision (Basel Committee), which comprises central banks and supervisory authorities from major countries.

The Bank, as and when necessary, conducts business requisite to maintaining financial system stability, including the provision of loans, pursuant to Article 38 of the Act (hereafter the term "special loans" covers all such business). The Bank decides on the extension of special loans based on the following four principles, taking into account the nature and purpose of the lender-of-last-resort function:

Principle 1

There must be a strong likelihood that systemic risk will materialize.

Principle 2

There must be no alternative to the provision of central bank money.

Principle 3

All relevant parties are required to take clear responsibility to avoid moral hazard.

Principle 4

The financial soundness of the Bank of Japan itself must not be impaired.

Table 1

Number of Financial Institutions that Conduct Transactions with the Bank as of the End of Fiscal 2007¹

	Financial institutions that hold current accounts at the Bank		Financial institutions that have concluded agreements for bilateral electronic lending with the Bank	Financial institutions that have concluded loans-on-bills agreements with the Bank	Financial institutions that have concluded intraday-overdraft agreements with the Bank
		Of which: Financial institutions that have concluded on-site examination contracts with the Bank			
City and regional banks	127 (124)	127 (124)	126 (123)	126 (123)	126 (123)
Trust banks	20 (21)	20 (21)	13 (13)	13 (13)	20 (20)
Foreign banks	61 (63)	61 (63)	44 (44)	50 (52)	46 (46)
<i>Shinkin</i> banks	268 (273)	268 (273)	96 (94)	126 (125)	125 (126)
Financial instruments firms	43 (42)	43 (42)	36 (35)	42 (41)	41 (40)
Bankers associations	33 (33)	0 (0)	0 (0)	0 (0)	0 (0)
Other institutions	21 (22)	11 (12)	10 (10)	11 (11)	14 (15)
Total	573 (578)	530 (535)	325 (319)	368 (365)	372 (370)

Note: 1. Figures in parentheses indicate the number of institutions as of the end of fiscal 2006.

Table 2

Number of Financial Institutions Examined

	Fiscal 2005	Fiscal 2006	Fiscal 2007
Domestic banks	42	43	39
<i>Shinkin</i> banks	73	73	66
Other institutions ¹	45	15	14
Total	160	131	119

Note: 1. Including financial instruments firms and Japanese branches of foreign banks.

III. ENHANCEMENT OF PAYMENT AND SETTLEMENT SYSTEMS AND MARKET INFRASTRUCTURE

The Bank provides safe and convenient settlement assets in the form of banknotes and deposits in financial institutions' current accounts held at the Bank. In addition, the Bank conducts settlement for Japanese government securities (JGSs) in its role as the book-entry transfer institution in the Japanese government bond (JGB) book-entry system. To ensure the safety and efficiency of these services, the Bank operates a computer network system for the settlement of funds and JGSs, the Bank of Japan Financial Network System (BOJ-NET).

To promote the smooth and stable operation of Japan's payment and settlement systems, the Bank encourages owners/operators of private-sector payment and settlement systems to enhance the safety and efficiency of their systems and cooperates with them to that end. Moreover, the Bank participates with foreign central banks in various international discussions and

initiatives related to payment and settlement systems, including those at the meetings of the Committee on Payment and Settlement Systems (CPSS) at the Bank for International Settlements (BIS).

The Bank also takes initiatives to improve the functioning and efficiency of the market infrastructure and to promote innovation in financial services and transactions by exchanging views with market participants, supporting the formulation of additional rules on and the revision of market practices, and compiling and releasing statistics on market transactions. As part of its initiatives, the Bank has continued to enhance its business continuity arrangements in preparation for times of disaster and other emergency situations, and has provided active support to market participants in developing effective business continuity planning (BCP) in financial markets, payment and settlement systems, and the financial system.

IV. ISSUANCE, CIRCULATION, AND MAINTENANCE OF BANKNOTES

The Bank, as the country's sole issuer of banknotes (Bank of Japan notes), ensures the stability of banknote supply and maintains public confidence in banknotes through the conduct of the following operations at its Head Office and branches in Japan. First, the Bank receives/pays banknotes from/to financial institutions that hold current accounts at the Bank (BOJ account holders). Second, the Bank counts the banknotes it receives from BOJ account holders, examines them to verify their authenticity, and checks their fitness for recirculation. As for coins, they are delivered to the

Bank by the government, which is the authorized issuer of coins, and then put into circulation.

As part of its measures to secure confidence in the currency, the Bank works to maintain the cleanliness of banknotes in circulation by preventing damaged or worn banknotes from being returned to circulation. In addition, the Bank remains active in advancing research and promoting public understanding regarding counterfeit deterrence and security for currency and other means of payment, in cooperation with relevant institutions at home and abroad, including other central banks.

V. SERVICES RELATING TO THE GOVERNMENT

The Bank provides various services relating to the government, such as treasury funds and JGS services. Specifically, these are (1) receipt, disbursement, and accounting of treasury funds (the Bank classifies receipts and disbursements of treasury funds by the specific government account as well as by the individual government agency); (2) management of the deposits of the Japanese government; (3) custody of securities acquired by or submitted to the government; (4) issuance of, and principal and interest payment on, JGSs; and

(5) operations relating to its role as the book-entry transfer institution in the JGB book-entry system. For the convenience of the public and government agencies across the country, the Bank designates certain branches and offices of financial institutions throughout the country as its agents and entrusts them with some of the services relating to treasury funds and JGSs.

Besides the above operations, the Bank engages in various transactions with the government, such as buying and selling JGSs.

VI. INTERNATIONAL OPERATIONS

The Bank conducts operations in the field of international finance, such as foreign exchange transactions, including those executed as part of the Bank's management of its foreign currency assets, as well as business related to assisting foreign central banks and international organizations in their investment in yen. The Bank also handles government affairs that relate to international finance such as the compilation and dissemination of Japan's balance of payments statistics and foreign exchange intervention.

In addition, the Bank takes part in international discussions on the state of the world economy as well as on measures to ensure the stability and to improve the structure of financial markets. The Bank participates

in various forums, such as meetings of the Group of Seven (G-7) countries, the Group of 20 (G-20) countries, the International Monetary Fund (IMF), the BIS, the Financial Stability Forum (FSF), and other meetings of monetary authorities including central banks in Asia.

In particular, the Bank's Center for Monetary Cooperation in Asia (CeMCoA) engages in activities to promote monetary cooperation in Asia and to strengthen technical cooperation and staff training, through participation in forums such as the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the Association of Southeast Asian Nations Plus Three (ASEAN Plus Three). It also conducts joint research on Asia with researchers from outside the Bank.

VII. RESEARCH AND STATISTICS

In order to implement monetary policy and carry out business operations effectively, the Bank conducts research on economic and financial conditions as well as the financial system and financial markets.

The findings are reflected in the Bank's releases including the *Monthly Report of Recent Economic and Financial Developments* and the *Outlook for Economic Activity and Prices*. The Bank makes its research findings widely available to the public in various reports such as the *Financial System Report*, the *Payment and Settlement Systems Report*, the *Financial Markets Report*, and the *Regional Economic Report*. The Bank's

research papers are also available in the *BOJ Reports & Research Papers*, the *Bank of Japan Working Paper Series*, the *Bank of Japan Review Series*, and research papers released by the Institute for Monetary and Economic Studies (IMES), namely those published in *Monetary and Economic Studies*, and the *IMES Discussion Paper Series*.⁵

Moreover, the Bank compiles and releases various statistics and also works to refine these statistics so as to grasp accurately economic and financial developments as well as structural changes taking place in Japan.

VIII. EXTERNAL RELATIONS

With a view to satisfying the requirements of public accountability, the Bank releases the minutes of MPMs and public statements on most of the Policy Board decisions in a timely manner. The Bank actively discloses information through a variety of channels including the following: reporting to and attendance at the Diet; press conferences held and speeches delivered by the Bank's officials; and the dissemination of information through the Bank's web site. From fiscal 2008, the transcripts of MPMs held more than ten years previously have been released.

To promote better understanding of the policies and business operations of the Bank not only in the eyes of financial professionals but also of the public, the Bank endeavors to make its publications and releases better suited to the diverse needs and interests of their users. The Bank also works to promote financial literacy among the public.

Meanwhile, the Bank discloses information in accordance with the Act on Access to Information Held by Incorporated Administrative Agencies, Etc.

5. Papers and statistics as well as lists of the Bank's publications in English are available at the Bank's web site (<http://www.boj.or.jp/en/index.htm>) and at the IMES web site (<http://www.imes.boj.or.jp/english/index.html>).

