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October 9, 2013

Bank of Japan

Minutes of the Monetary Policy Meeting

on September 4 and 5, 2013

(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 Wednesday, September 4, 2013, from 2:00 p.m. to 4:30 p.m., and on Thursday, September 5, from 9:00 a.m. to 11:37 a.m.[1]

Policy Board Members Present

Mr. H. Kuroda, Chairman, Governor of the Bank of Japan

Mr. K. Iwata, Deputy Governor of the Bank of Japan

Mr. H. Nakaso, 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. S. Yamaguchi, Senior Vice Minister of Finance, Ministry of Finance[2]

Mr. S. Sato, Deputy Vice Minister, Ministry of Finance[3]

Mr. K. Umetani, Vice Minister for Policy Coordination, Cabinet Office

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director (Assistant Governor)

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

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

Mr. H. Yamaoka, Director-General, Financial Markets Department

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on October 3 and 4, 2013 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. S. Yamaguchi was present on September 5.

[3] Mr. S. Sato was present on September 4.

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

Mr. S. Kameda, Head of Economic Research Division, Research and Statistics Department

Mr. H. Toyama, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. N. Yoshioka, Director-General, Secretariat of the Policy Board

Mr. N. Fukunaga, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. K. Iijima, Senior Economist, Monetary Affairs Department

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

I. Summary of Staff Reports on Economic and Financial Developments[4]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on August 7 and 8, 2013, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, the amount outstanding of the monetary base had been in the range of 169-178 trillion yen.

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been at low levels. The uncollateralized overnight call rate had been at a level below 0.1 percent. General collateral (GC) repo rates had generally been at around 0.1 percent, although they had temporarily weakened somewhat. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been somewhat below the 0.1 percent level for all maturities. Rates on longer-term interbank instruments had been flat.

Long-term interest rates in Japan had generally been more or less flat, partly due to the Bank's JGB purchases and a slight drop in Japanese stock prices, although U.S. and German long-term interest rates had been rising on the back of speculation about the direction of U.S. monetary policy and the release of economic indicators in the United States and European countries that were stronger than market expectations. The Nikkei 225 Stock Average had dropped slightly, reflecting a decline in stock prices in the United States and Asian emerging economies that was partly related to uncertainties regarding the situation in the Middle East. Prices for Japan real estate investment trusts (J-REITs) had declined somewhat. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, despite a widening in some corporate bond spreads. In the foreign exchange market, the yen had depreciated against the U.S. dollar, mainly due to firm U.S. economic indicators. The U.S. dollar/yen rate had recently been in the range of 99-100 yen.

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

[5] The guideline was as follows:

The Bank of Japan will conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

C. Overseas Economic and Financial Developments

Overseas economies as a whole were gradually heading toward a pick-up, although a lackluster performance was partly seen.

The U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, despite downward pressure from the fiscal side. Private consumption remained on a moderate increasing trend as the employment situation followed an improving trend and asset prices rose. Housing investment also continued to generally pick up. Exports were increasing moderately. On the other hand, federal government expenditures -- particularly federal defense spending -- had been declining, and this was affecting defense-related industries. The pace of pick-up in production and business fixed investment therefore remained slow, but business sentiment had been improving. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less food and energy, or the core CPI, had been more or less flat at a relatively low level. In this situation, the year-on-year rate of increase in the CPI for all items had risen somewhat, mainly as a result of the increase in energy prices.

Economic activity in Europe as a whole had bottomed out. While business fixed investment had been declining, exports had bottomed out. Private consumption had stopped decreasing, with a continued improvement in consumer sentiment, although the employment and income situation remained severe. Reflecting these developments in demand, production had bottomed out. As for prices, while slack in supply and demand conditions had been exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items excluding energy and unprocessed food was on a declining trend. Annual HICP inflation for all items, on the other hand, was unchanged due to the rise in food prices. Meanwhile, economic activity in the United Kingdom was picking up.

With regard to Asia, the Chinese economy continued to see stable growth, albeit at a somewhat lower level than before, as the government engaged in a variety of reforms. Private consumption had been firm on the back of a favorable employment and income situation, although effects of the government's frugality campaign continued to be observed in some areas. The pace of increase in fixed asset investment had been solid, mainly due to rises in infrastructure investment and real estate investment, although the pace had become somewhat slower in manufacturing. Exports had been heading toward a moderate pick-up, but continued to show some weakness. Production growth had slowed now that it was partly affected by developments in exports. As for prices, the year-on-year rate of increase in the CPI had been somewhat low. Regarding the NIEs and the ASEAN countries, developments toward a pick-up had been weakening on the whole, not only because trade had been sluggish but also because domestic demand had decelerated. Private consumption had been decelerating against the background of (1) the waning of policy effects on car sales and (2) consumer sentiment having turned cautious. Exports continued to show some weakness and moves toward a pick-up in production remained paused. Growth in business fixed investment, particularly in machinery investment, had been sluggish, as business sentiment remained cautious. As for prices, inflation rates generally continued to be at somewhat low levels, although there were regional differences. In India, there were signs that a deceleration was strengthening somewhat.

Global financial markets had become nervous on the back of, for example, speculation about the direction of U.S. monetary policy and uncertainties regarding the situation in the Middle East. In this situation, stock prices in the United States and Europe had been declining. In the bond market, yields on government bonds in the United States and European countries had been rising, partly due to speculation about the direction of U.S. monetary policy and the release of economic indicators in the United States and European countries that were stronger than market expectations. In some emerging economies, outflows of funds continued on the back of a decline in growth expectations and a heightening of investors' risk aversion, resulting in simultaneous declines in stock prices and bond prices as well as a depreciation in foreign exchange rates. Yield differentials between sovereign bonds in emerging economies and U.S. Treasuries had been widening again. Meanwhile, international commodity prices had recently picked up somewhat, although they continued to be weak from a relatively longer-term perspective in a situation where recovery in emerging economies lacked momentum.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had generally been picking up. Real exports had turned upward in the January-March quarter of 2013 on a quarter-on-quarter basis for the first time in three quarters and had grown at an accelerated rate in the April-June quarter. They then decreased in July compared with the April-June quarter. Recent movements in real exports seemed to be attributable to some extent to short-term fluctuations, including technical factors that emanated from the compilation of statistics. Exports were expected to increase moderately, mainly against the background of the pick-up in overseas economies.

Public investment continued to increase. It was expected to continue trending upward, supported by the effects of various economic measures.

Business fixed investment was starting to pick up as corporate profits had improved. According to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, business fixed investment in nominal terms had grown at an accelerated rate in the April-June quarter of 2013, after having increased -- albeit slightly -- in both the October-December quarter of 2012 and the January-March quarter of 2013 on a quarter-on-quarter basis. The aggregate supply of capital goods -- a coincident indicator of machinery investment -- had kept rising in the April-June quarter on a quarter-on-quarter basis, after having turned upward in the January-March quarter. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- had turned upward in the April-June quarter for the first time in five quarters, after having been almost flat in the January-March quarter. Business fixed investment was projected to follow a moderate increasing trend as corporate profits continued to improve.

As for the employment and income situation, supply and demand conditions in the labor market continued to improve moderately and employee income had also shown a pick-up.

Private consumption remained resilient, with some improvement observed in the employment and income situation. Sales at retail stores in real terms had fallen in July relative to the April-June quarter of 2013, after having risen in both the January-March and April-June quarters on a quarter-on-quarter basis. On a quarterly basis, sales at department stores had increased for three quarters in a row since the October-December quarter of 2012. They then dropped in July relative to the April-June quarter of 2013, due in part to the reversal of an increase in sales in June as a result of temperature rises and the front-loading of summer discount sales. Sales at convenience stores continued to trend moderately upward. Sales in the food service industry as a whole had held steady. Private consumption was expected to remain resilient, supported by improvement in the employment and income situation.

The pick-up in housing investment had become evident, and such investment was expected to increase.

Reflecting these developments in demand both at home and abroad, industrial production was increasing moderately. It had turned upward -- albeit marginally -- in the January-March quarter of 2013 on a quarter-on-quarter basis for the first time in four quarters, and continued to exhibit firm growth in the April-June quarter on the same basis, and in July compared with the April-June quarter. Industrial production was expected to continue increasing moderately, mainly reflecting developments in demand at home and abroad. Judging from interviews with firms and other relevant information, production was projected to advance markedly in the July-September quarter, and appeared likely to continue increasing in the October-December quarter, although there was a high degree of uncertainty.

As for prices, the domestic corporate goods prices were rising moderately relative to three months earlier against the backdrop of movements in international commodity prices and foreign exchange rates. The domestic corporate goods prices were expected to continue rising moderately for the time being. The year-on-year rate of change in the CPI (all items less fresh food) was in the range of 0.5-1.0 percent, and was likely to rise gradually. Meanwhile, inflation expectations appeared to be rising on the whole, considering the results of surveys conducted on households, economists, and market participants.

2. Financial environment

Financial conditions were accommodative.

The monetary base had increased significantly as asset purchases by the Bank had progressed, and the year-on-year rate of growth had been in the range of 40-45 percent.

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 continued to be favorable. Those for corporate bonds also remained favorable on the whole. Firms' credit demand had been increasing moderately, 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 been in the range of 2.0-2.5 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds had been positive. Firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of growth in the money stock had been in the range of 3.5-4.0 percent, mainly due to the increase in bank lending.

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

On September 6, 2013, the Bank was scheduled to carry out a new loan disbursement, amounting to 180.8 billion yen, under the main rules for the fund-provisioning measure to support strengthening the foundations for economic growth. The outstanding balance of loans disbursed by the Bank under these rules would amount to 3,286.5 billion yen after the new loan disbursement, thus exceeding 3 trillion yen, as in the previous loan disbursement. The outstanding balance of loans disbursed by the Bank under the special rules for equity investments and asset-based lending (ABL) was scheduled to be 111.3 billion yen, and that under the special rules for small-lot investments and loans to be 6.930 billion yen. As for the special rules for the U.S. dollar lending arrangement, the Bank would implement its new loan disbursement of 1.636 billion dollars, bringing the outstanding balance of loans to 6.599 billion dollars. The breakdown of investments and loans provided by financial institutions that were to receive the Bank's loans under the special rules for the U.S. dollar lending arrangement showed that those to be used abroad accounted for the majority of the total.

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

A. Economic Developments

Members shared the recognition that global financial markets had become nervous on the back of, for example, speculation about the direction of U.S. monetary policy and uncertainties regarding the situation in the Middle East. A few members pointed out that, although the Federal Reserve's policy intention was permeating the markets, long-term interest rates in the United States and European countries had been rising, reflecting speculation about the timing as to when the Federal Reserve would reduce the pace of its asset purchases as well as firm U.S. and European economic indicators. As for emerging markets, many members pointed out that outflows of funds were observed in some emerging economies where currencies were depreciating and stock prices were declining. Some of these members added that such developments were becoming increasingly apparent among emerging economies with a current account deficit in a situation where their economic structures were drawing attention triggered by speculation about the direction of U.S. monetary policy. One member pointed out that the situation in emerging markets could be regarded as part of an adjustment of imbalances built up over a long period based on excessive expectations for economic growth. In response to these views, a few members noted that emerging economies as a whole remained resilient against outflows of funds, since many emerging economies held abundant foreign exchange reserves and had established backstops such as currency swap arrangements that offered liquidity in non-domestic currencies. One of these members pointed out that, while the Asian currency crisis of the late 1990s was a solvency crisis, the current situation in emerging markets suggested that they faced problems in the area of market risk -- namely, an increase in market volatility.

Members concurred that overseas economies as a whole were gradually heading toward a pick-up, although a lackluster performance was partly seen. As for the outlook, they shared the recognition that overseas economies, advanced economies in particular, would gradually pick up as downward pressure from the fiscal side was reduced in Europe and the United States. Many members expressed the view that attention should be paid to various uncertainties regarding the outlook, as observed, for example, in the differences in the pace of improvement in economic activity by region and industry.

Members agreed that the U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, such as private consumption and housing investment, despite downward pressure from the fiscal side. One member noted that the mechanism for a self-sustained recovery appeared to operate properly on the whole as firms' and households' credit demand had been firm in a situation where, in addition to private consumption, business sentiment was improving. As for the outlook, members concurred that the pace of economic recovery would gradually rise, albeit moderately, as downward pressure from the fiscal side would ease gradually and accommodative financial conditions would probably continue. Many members pointed out that some recent indicators with respect to housing investment were relatively weak, and thus future developments, including the effects of rising mortgage rates, warranted attention. Some members expressed the intent to pay close attention to future developments related to the debt ceiling problem. One member pointed out that it would be necessary to pay attention to whether, amid the disinflationary trend, a decline in short-term expected inflation rates would lead to a decline in medium- to long-term expected inflation rates, which were currently anchored.

Members shared the recognition that economic activity in the euro area as a whole had bottomed out. Many members referred to the fact that the real GDP growth rate in the April-June quarter of 2013 had turned positive for the first time in seven quarters, and also noted that favorable economic indicators could recently be confirmed by not only sentiment indicators and the Purchasing Managers' Index (PMI) but also hard data. One member added that strong improvement in both domestic and external demand continued to be seen in the United Kingdom. As for the outlook, members concurred that the euro area economy would gradually start picking up, triggered by an improvement in economic entities' sentiment and the pick-up in exports. On this basis, they shared the recognition that there remained a high degree of uncertainty concerning the prospects for the European debt problem.

Members agreed that the Chinese economy continued to see stable growth, albeit at a somewhat lower level than before, as the government engaged in a variety of reforms. As for the outlook, they shared the view that, while external demand would lack strength, domestic demand was likely to remain firm, mainly on the back of a favorable employment and income situation, and therefore the economy would continue to see stable growth at around the current pace. Some members, noting that recent economic indicators suggested that the effects of the measures taken by the Chinese government to underpin the economy had begun to materialize, pointed out that concerns about deceleration had receded somewhat.

Regarding the NIEs and the ASEAN countries, members concurred that developments toward a pick-up had been weakening on the whole, not only because trade had been sluggish but also because domestic demand had decelerated. One member noted that the view could be maintained that these economies would head toward a pick-up on the whole, albeit with some differences in degree by country. As for the outlook, members shared the view that the pace of economic growth would likely remain relatively slow for the time being, but thereafter it would gradually rise on the premise that advanced economies would pick up and financial markets would stabilize. Some members pointed out that it was necessary to closely monitor whether instability observed in some emerging markets would persist and the tightening of the financial environment or the negative wealth effects stemming from the fall in stock prices would lower the growth momentum of emerging economies as a whole.

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

With regard to economic activity, members shared the view that a virtuous cycle from income to spending had gradually started to operate firmly both in the corporate and household sectors: in the corporate sector, improved profits were exerting positive effects on business fixed investment; and in the household sector, improvement in the employment and income situation was playing a role in supporting private consumption. Based on this view, they agreed that it was appropriate to upgrade the assessment of the economy from the phrase used in the previous month that the economy was "starting to recover moderately" to "recovering moderately." Some members said that economic indicators released since the previous meeting had generally been favorable and upward momentum in the overall economy had been observed, which suggested that a virtuous cycle among production, income, and spending was working steadily. One member was in agreement with the upgrading of the economic assessment on the ground that the economy was likely to register high growth rates for two consecutive quarters, despite being somewhat concerned about the weak momentum toward recovery for exports and the somewhat low level of manufacturing activity. As for the outlook for the economy, members shared the view that the economy was likely to continue a moderate recovery.

Members shared the recognition that, as the U.S. economy recovered moderately, Japan's exports had generally been picking up, underpinned partly by developments in foreign exchange rates. As for the outlook, they agreed that exports were likely to increase moderately, mainly against the background of the pick-up in overseas economies. With regard to the decline in real exports in July 2013, some members said that exports were continuing to pick up generally, taking into account the accumulation of inventories of automobiles awaiting shipment overseas and developments in industrial production in July and onward, in addition to technical factors that emanated from the compilation of statistics on real exports. Some members expressed the view that the pace of increase in exports was slower than expected. A few members noted that this might be attributed to such structural factors as a decline in the competitiveness of Japanese exporting firms and the shift of Japanese firms' production sites to overseas. One member pointed out that the slower-than-expected growth in Japan's exports was partly attributable to the slow pace of recovery in demand in the United States and Europe -- the world's two largest markets for the consumption of final goods. This member then said that close attention should therefore be paid as to whether U.S. and European domestic demand would pick up. A few members expressed the view that it was necessary to pay attention to the possibility that Japan's exports to Asia in particular might register lower growth in the future, given that the component for new export orders in Japan's PMI had recently been relatively weak and emerging markets had become unstable.

Members agreed that business fixed investment was starting to pick up as corporate profits had improved. Many members said that positive developments in the corporate sector were confirmed by the *Financial Statements Statistics of Corporations by Industry, Quarterly*, which showed that business fixed investment had grown at an accelerated rate in the April-June quarter of 2013 on a quarter-on-quarter basis. In relation to this, many members expressed the view that the first preliminary estimate of real GDP for the April-June quarter was likely to be revised upward in the second preliminary estimate. One member expressed the opinion that business fixed investment was likely to gradually follow an increasing trend, given that machinery orders were firm both in manufacturing and nonmanufacturing in the April-June quarter. Some members pointed out that, although business fixed investment in nonmanufacturing was firm, that in manufacturing remained weak. A few members noted that the reason for this weakness was that the capacity utilization rate remained low because the level of production in manufacturing was low compared to its most recent peak. On the other hand, a few members pointed out that there was considerable potential demand, such as that for investment for maintenance and replacement as well as research and development, since (1) the existing capital stock in manufacturing had become aged, (2) business fixed investment had been restrained compared with past developments in the capital stock cycle, and (3) research and development spending had also been restrained. On this basis, these members said that business fixed investment in manufacturing was likely to increase gradually.

As for the employment and income situation, members shared the view that supply and demand conditions in the labor market continued to improve moderately and employee income had also shown signs of a pick-up. Some members pointed out that special cash earnings for June and July 2013 showed a clear increase and the decline in nominal wages per worker was coming to a halt. These members continued that a virtuous cycle from income to spending had started to operate even in the household sector. Members shared the recognition that private consumption remained resilient, with some improvement observed in the employment and income situation. One member said that the employment and income situation was expected to continue improving for the time being, as (1) the supply-demand balance in the labor market was improving, with the unemployment rate declining; and (2) corporate profits were also increasing. On this basis, this member added that these positive developments were likely to underpin the firmness in private consumption through an improvement in the outlook for permanent income -- a fundamental factor. A different member pointed out that, although private consumption had been increasing so far, reflecting wealth effects stemming from the rise in stock prices, the sustainability of the recovery warranted attention since these effects had recently been waning. Members concurred that the pick-up in housing investment had become evident. They shared the view that industrial production was increasing moderately, reflecting these developments in demand both at home and abroad.

Based on the above discussion, some members said that, unlike the pattern of past recoveries, which were driven mainly by a recovery in manufacturing led by exports, a notable characteristic of the current phase of recovery was that it was driven mainly by nonmanufacturing led by private consumption. One of these members added that, compared with past phases in which the Bank provided its assessment that the economy was recovering moderately, figures in the Indices of Tertiary Industry Activity were at rather high levels while figures for the industrial production index were at low levels. On this basis, members shared the view that, even if the pattern of recovery was different from previous ones, the negative output gap was narrowing steadily given that the economy was likely to register high growth for two consecutive quarters at a pace exceeding its potential growth rate. Meanwhile, some members said that, in order for the virtuous cycle among production, income, and spending to become increasingly firm, economic recovery needed to be accompanied by a recovery in manufacturing, led by exports and business fixed investment.

Regarding prices, members concurred that the year-on-year rate of change in the CPI (all items less fresh food) was in the range of 0.5-1.0 percent, and was likely to rise gradually. Many members expressed the view that recent movements in the CPI were attributable to not only upward pressure from movements in energy-related goods but also price rises observed across a wide range of items. A few members said that positive effects on prices had appeared, as evident in firms' introduction of high-value-added products and services as well as in aggressive price-setting behavior against the backdrop of resilient private consumption. In response to this, one member expressed the view that the aforementioned rise in the year-on-year rate of increase in the CPI might come to a pause as effects of the reversal of the previous year's decline in energy prices disappeared. One member pointed out that, despite rising prices, real income had been increasing, since employee income had been rising at a pace exceeding CPI inflation. A different member expressed the intent to pay close attention to the course of next year's spring wage negotiations, noting the importance of movements in scheduled cash earnings in assessing future price developments. One member was closely monitoring whether factors specific to Japan could lead to a rise in the rate of change in the CPI in a situation where signs of improvement in the global disinflationary trend could not yet be observed. As for inflation expectations, members shared the recognition that, considering the results of surveys conducted on households, economists, and market participants, these appeared to be rising on the whole. One member said that the key point was whether an environment that allowed firms to raise their sales prices was being created as inflation expectations rose moderately. With regard to interpreting developments in inflation expectations, a different member expressed the opinion that it should be noted that identifying the effects of perceptions regarding the likelihood of the consumption tax hikes was difficult.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative. They shared the view that the monetary base had increased significantly, reflecting the progress in asset purchases by the Bank, and that firms' funding costs had been hovering at low levels. Members agreed that firms continued to see financial institutions' lending attitudes as being on an improving trend, issuing conditions for CP continued to be favorable, and those for corporate bonds also remained favorable on the whole. They concurred that firms' credit demand had been increasing moderately, as seen in the fact that the year-on-year rate of increase in the amount outstanding of bank lending had been in the range of 2.0-2.5 percent and the year-on-year rate of change in the amount outstanding of CP and corporate bonds had been positive. One member pointed out that many indicators related to the financial positions of small firms had improved, reaching the most recent peak levels seen around 2006.

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

Based on the above assessment of economic and financial 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 conduct money market operations so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

With regard to the asset purchases, members concurred that it was appropriate for the Bank to continue with the guidelines decided when it introduced quantitative and qualitative monetary easing at the meeting on April 3 and 4, 2013. Specifically, they confirmed the following. First, the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases would be about seven years. Second, it would purchase exchange-traded funds (ETFs) and J-REITs so that their amounts outstanding would increase at an annual pace of about 1 trillion yen and about 30 billion yen, respectively. And third, for CP and corporate bonds, the Bank would continue with these asset purchases until their amounts outstanding reached 2.2 trillion yen and 3.2 trillion yen, respectively, by end-2013; thereafter, it would maintain these amounts outstanding.

With respect to the future conduct of monetary policy, most members shared the view that the Bank would continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining this target in a stable manner. These members continued that, in doing so, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. One of these members pointed out that, in order to achieve the price stability target of 2 percent, it was essential that people's expectations for inflation rates be anchored at around 2 percent, and therefore the Bank needed to make efforts to gain their deeper understanding that achieving the price stability target of 2 percent was important. A different member noted market participants' increasing understanding that quantitative and qualitative monetary easing was characterized by a marked shift in the Bank's monetary policy through an initial bold move, not by adopting easing measures in an incremental manner. One member pointed out that the approach of examining both upside and downside risks and making adjustments as appropriate without hesitation was important with regard to enhancing the credibility of the conduct of monetary policy. In response to these views, one member expressed concern that, in a situation where it seemed difficult to achieve the price stability target in about two years, if a rise were to occur in markets' anticipation that quantitative and qualitative monetary easing would continue for a protracted period or extreme additional measures would be implemented, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, this member said that it was appropriate to change the expression representing the Bank's commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner.

With regard to the effects of quantitative and qualitative monetary easing, members shared the recognition that these were firmly taking hold, and financial conditions were easing steadily to underpin firms' and households' spending. They agreed that, in this situation, there was a wider range of positive movements in economic activity and financial markets, and people's expectations for economic activity and prices had turned favorable.

Regarding how much of an effect could be exerted on longer-term interest rates, many members expressed the view that long-term interest rates in Japan had been stable. These members noted that the Bank's massive JGB purchases were significantly restraining upward pressure on long-term interest rates that stemmed from the rise in overseas interest rates and an improvement in perceived business conditions. Meanwhile, one member said that, taking into consideration recent developments in the U.S. economy, the stability of long-term interest rates might change even with the progress in purchases of government bonds, should there be a change in expectations. A few members said that, in continuing with the Bank's JGB purchases, it was necessary to closely monitor developments in the JGB market through various indicators, such as those of market liquidity and the sales/purchases of JGBs by respective market investors, in addition to JGB yields. One of these members noted that, as for liquidity in the bond market, the ratio of the daily price range to the transaction volume in the JGB futures market remained at a relatively high level, and that there was a risk that large fluctuations would occur in the bond market. In relation to developments in the JGB market, some members expressed the recognition that it was essential that the credibility of fiscal management be maintained to ensure the stability of financial markets and to make quantitative and qualitative monetary easing effective, and that they therefore expected the government to steadily promote measures aimed at achieving fiscal consolidation.

With regard to effects brought about through fundamental changes in economic entities' expectations, many members expressed the view that, in a situation where nominal interest rates had been stable, real interest rates were declining on the back of a rise in inflation expectations. One of these members pointed out that there was a time lag between the permeation of monetary policy effects into asset markets and that into economic activity -- particularly into business fixed investment. This member added that the rise in inflation expectations and the accompanying decline in real interest rates would progress further, as inflation expectations were in the process of rising toward 2 percent. Meanwhile, one member expressed the view that the portfolio rebalancing effect would gradually permeate the economy -- for example, lending by financial institutions would increase as credit demand in the corporate sector, such as for business fixed investment, rose.

Regarding <u>the fund-provisioning measure to support strengthening the foundations for economic growth</u>, one member pointed out that, in addition to medical and nursing care business as well as environment and energy business -- areas on which a large portion of funds provided by the Bank had been spent -- funds were increasingly being spent on areas that had previously accounted only for a small portion, such as tourism business. This member continued that private financial institutions' efforts to support strengthening the foundations for economic growth were spreading steadily. A different member commented that the special rules for the U.S. dollar lending arrangement had brought a steady rise in the total amount of loans disbursed by the Bank and had been used more widely, and that the rules had been exerting their intended effects of supporting firms' responses to globalization, thereby contributing to Japan's economic growth.

IV. Remarks by Government Representatives

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

(1) The government acknowledged that recent price developments as a whole indicated that deflation was ending, as evidenced, for example, by the fact that domestic corporate goods prices had been rising at a moderate pace and consumer prices had been flat as a trend. It expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing and achieve the price stability target of 2 percent at the earliest possible time.

(2) The government had been working toward achieving both private demand-led economic growth and fiscal consolidation with a view to playing its role as specified in the joint statement by the government and the Bank released in January 2013. On the expenditure side, the government had recently compiled and released the fiscal 2014 budget requests based on requests submitted by ministries and agencies in accordance with the guidelines for budget requests for fiscal 2014 compiled in August 2013. Toward the year-end, the government, taking into account the Medium-Term Fiscal Plan, would work to formulate a budget by examining the details of the budget requests and focusing primarily on areas with high priority. On the revenue side, the government had held intensive review meetings concerning the economic and fiscal situation -- which Governor Kuroda attended -- with a view to hearing the opinions of experts and specialists from wide-ranging fields in the private sector for use as a reference when taking into comprehensive consideration the economic situation in relation to the raising of consumption tax rates. The Cabinet would make an appropriate decision on the raising of consumption tax rates by examining various economic indicators and considering the economic situation comprehensively.

(3) Prime Minister Abe and Deputy Prime Minister Aso would participate in the Group of Twenty (G-20) Leaders' Summit held from September 5 to 6, 2013 in St. Petersburg, Russia. At this summit, the government would explain "Abenomics," and show its

determination to contribute to global economic growth through revitalization of the Japanese economy. It would also explain the Medium-Term Fiscal Plan compiled in August 2013, and seek to ensure credibility worldwide in Japan's efforts toward achieving economic revitalization and fiscal consolidation.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was picking up steadily and showing some movement toward self-sustained recovery. As for the outlook, the recovery was expected to resume as the improvement in corporate profits led to increases in household income and business investment, while exports picked up and the effects of a range of policies developed. Recent price developments as a whole indicated that deflation was ending, as evidenced, for example, by the fact that consumer prices -- all items less fresh food, petroleum products, and other specific components -- had been flat as a trend.

(2) From August 26 to 31, 2013, the government had held intensive review meetings concerning the economic and fiscal situation, which Governor Kuroda attended. At these meetings, it heard the opinions of experts and specialists on what deserved attention with regard to conducting economic and fiscal management, as well as what efforts it should make, in order to use such opinions as a reference when taking into comprehensive consideration the economic situation in relation to the raising of consumption tax rates. At the meetings, the government had received quite valuable opinions, and judged the meetings to be meaningful. In taking into comprehensive consideration the economic situation in relation to the raising of consumption tax rates, the government deemed that the discussions during the meetings would be a basis for the Prime Minister's final decision on the raising of consumption tax rates. In addition, before the extraordinary session of the Diet on the growth strategy implementation got underway in autumn 2013, the government would compile a policy for the near future regarding the implementation of growth strategy-related measures, including formulating a bill for strengthening industrial competitiveness and laying out the details of a special zone in a national strategy, in order to accelerate and strengthen the implementation of the Japan Revitalization Strategy.

(3) While recent price developments as a whole indicated that deflation was ending, the overcoming of deflation -- in the sense that price trends would turn upward and be

expected to continue increasing -- was still only halfway accomplished. Therefore, the government deemed it necessary to give particular attention to the developments in prices and economic activity. It expected the Bank to continue its efforts to achieve the price stability target of 2 percent.

V. Votes

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

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 conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. A public statement will be decided separately.

> Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, 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

On the basis of the above discussions, members discussed the Statement on Monetary Policy and formed a majority view. One member, however, formulated a proposal, and thus the following two proposals were submitted.

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T.

Kiuchi proposed changing the current expression of the Bank's future monetary policy stance that "the Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" to a new expression that "the Bank will aim to achieve the price stability target of 2 percent in the medium to long term. On this basis, it will designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years, and thereafter will review the monetary easing measures in a flexible manner." The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. T. Kiuchi.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.

B. The Chairman's Policy Proposal

The chairman formulated the Statement on Monetary Policy, and put it 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 August 7 and 8, 2013 for release on September 10, 2013.

Attachment

September 5, 2013

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 conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. With regard to the asset purchases, the Bank will continue with the following guidelines:

   a) The Bank will purchase Japanese government bonds (JGBs) so that their amount outstanding will increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases will be about seven years.

   b) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at an annual pace of about 1 trillion yen and about 30 billion yen respectively.

   c) As for CP and corporate bonds, the Bank will continue with those asset purchases until their amounts outstanding reach 2.2 trillion yen and 3.2 trillion yen respectively by end-2013; thereafter, it will maintain those amounts outstanding.

3. Japan's economy is recovering moderately. Overseas economies as a whole are gradually heading toward a pick-up, although a lackluster performance is partly seen. In this situation, exports have generally been picking up. Business fixed investment is starting to pick up as corporate profits have improved. Public investment has continued to increase, and the pick-up in housing investment has become evident. Private consumption has remained resilient, with some improvement observed in the employment and income situation. Reflecting these developments in demand both at home and abroad, industrial production is increasing moderately. Meanwhile, financial conditions are accommodative. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh

food) is in the range of 0.5-1.0 percent. Inflation expectations appear to be rising on the whole.

4. With regard to the outlook, Japan's economy is expected to continue a moderate recovery. The year-on-year rate of increase in the CPI is likely to rise gradually.

5. Regarding risks, there remains a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem, developments in the emerging and commodity-exporting economies, and the pace of recovery in the U.S. economy.

6. The Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.[Note]

   Such conduct of monetary policy will support the positive movements in economic activity and financial markets, contribute to a rise in inflation expectations, and lead Japan's economy to overcome the deflation that has lasted for nearly 15 years.

[Note] Mr. T. Kiuchi proposed that the Bank will aim to achieve the price stability target of 2 percent in the medium to long term and designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years. The proposal was defeated by an 8-1 majority vote. Voting for the proposal: Mr. T. Kiuchi. Voting against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.