Not to be released until 8:50 a.m. Japan Standard Time on Friday, October 10, 2008.

October 10, 2008

Bank of Japan

# Minutes of the Monetary Policy Meeting

## on September 16 and 17, 2008

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Tuesday, September 16, 2008, from 2:00 p.m. to 4:47 p.m., and on Wednesday, September 17, from 9:00 a.m. to 12:42 p.m.[1]

**Policy Board Members Present**

**Mr. M. Shirakawa, Chairman, Governor of the Bank of Japan**

**Mr. K. G. Nishimura, Deputy Governor of the Bank of Japan**

**Ms. M. Suda**

**Mr. A. Mizuno**

**Mr. T. Noda**

**Mr. S. Nakamura**

**Mr. H. Kamezaki**

Government Representatives Present

Mr. W. Takeshita, Senior Vice Minister of Finance, Ministry of Finance[2]

Mr. C. Kawakita, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

Mr. B. Fujioka, Vice Minister for Policy Coordination, Cabinet Office

Reporting Staff

Mr. H. Yamaguchi, Executive Director

Mr. K. Ido, Executive Director

Mr. K. Yamamoto, Executive Director

Mr. M. Amamiya, Director-General, Monetary Affairs Department

Mr. T. Sekine, Associate Director-General, Monetary Affairs Department

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

Mr. K. Momma, Director-General, Research and Statistics 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 6 and 7, 2008 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. W. Takeshita was present on September 17.

[3] Mr. C. Kawakita was present on September 16.

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

Mr. T. Nunami, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. K. Osugi, Director-General, Secretariat of the Policy Board

Mr. K. Shigyoh, Director, Deputy Head of Secretarial Services for the Board, Secretariat of the Policy Board

Mr. T. Kato, Senior Economist, Monetary Affairs Department[4]

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

Mr. R. Hattori, Senior Economist, Monetary Affairs Department

[4] Mr. T. Kato was present on September 16 for the whole of the session, and on September 17 from 10:30 a.m. to 12:42 p.m.

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

### A. Money Market Operations in the Intermeeting Period

The Bank conducted money market operations in accordance with the guideline decided at the previous meeting on August 18 and 19, 2008, and as a result, the uncollateralized overnight call rate had been at around 0.5 percent.[6] The supply-demand balance of funds had tightened rapidly and upward pressure on interest rates had increased since the middle of September mainly reflecting the failure of a major U.S. investment bank. In response to this, the Bank had conducted money market operations flexibly, for example, by conducting same-day funds-supplying operations before the regular operation time.

### B. Recent Developments in Financial Markets

Money market rates were more or less flat on the whole, but market liquidity had decreased recently as market participants had become increasingly risk averse mainly reflecting the failure of a major U.S. investment bank and Euroyen rates and the general collateral (GC) repo rate had increased substantially.

Japanese stock prices rallied temporarily after the U.S. authorities made public their plan, in particular their decision to place two government-sponsored enterprises (GSEs) in conservatorship and to commit public funds to support them. However, they had recently fallen back substantially amid the drop in global stock prices against the background of the recent developments among U.S. financial institutions. The Nikkei 225 Stock Average had been moving in the range of 11,000-12,000 yen recently.

Long-term interest rates continued to follow those in the United States and Europe. In particular, their recent decline reflected the sharp fall in U.S. and European long-term interest rates mainly due to a "flight to quality" in markets. They had recently been in the 1.4-1.5 percent range.

The yen remained more or less unchanged against the U.S. dollar with some fluctuations, but had appreciated recently to trade in the range of 104-105 yen to the dollar.

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

[6] The guideline was as follows:

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.5 percent.

## C. Overseas Economic and Financial Developments

Growth in the U.S. economy had remained sluggish. A substantial decline in housing investment continued, and home prices continued to fall. Private consumption had continued to be more or less unchanged as the effects of income tax rebates, which previously boosted private consumption, subsided. The deceleration in business fixed investment had also continued. In this situation, industrial production had been on a downward trend and the number of employees had continued to decline. As for prices, the year-on-year rate of increase in consumer prices had been elevated, not only in terms of the consumer price index (CPI) for all items but also the CPI for all items less energy and food, or the core CPI, which registered a year-on-year rate of increase of around 2.5 percent.

A slowdown in the economy of the euro area had become more evident. The pace of increase in business fixed investment had decelerated and that in exports had also slowed. In addition, housing investment had been on a declining trend, and private consumption had decreased reflecting the earlier rise in energy and food prices and uncertainty about the outlook for the economy. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) remained at a high level, due to the earlier rise in commodity prices. The U.K. economy had been decelerating mainly due to significant adjustments in the housing market.

In China, both domestic and external demand continued to expand strongly. India's economy continued to show relatively high growth, although it was slowing. The pace of growth in the NIEs and ASEAN economies had decelerated as exports continued to decelerate and a slowdown in domestic demand, particularly private consumption, had become more evident. As for prices, the year-on-year rate of increase in the CPI for all items had remained elevated in many Asian economies.

Global financial markets remained unstable due to concerns about the possibility of a further slowdown of the world economy and anxiety about the financial soundness of U.S. and European financial institutions. Adjustments in markets for securitized products had continued, and credit spreads had widened further. U.S. and European stock prices continued to fluctuate reflecting both negative and positive factors; often declining when the market's view of the economy deteriorated due to relatively weak economic indicators, but rising when the rescue package for the two GSEs was viewed positively by the market. However, they had been declining recently against the background of the recent developments among U.S. financial institutions. U.S. and European long-term interest rates declined due to concerns about further deceleration of these economies and had recently fallen substantially mainly due to a "flight to quality" in markets.

## D. Economic and Financial Developments in Japan

1. Economic developments

The pace of increase in exports had slowed. Growth in exports was expected to remain only modest for the time being, due to the slowdown in overseas economies.

With regard to domestic private demand, corporate profits had been decreasing mainly due to the deterioration in the terms of trade, and business fixed investment had declined somewhat lately. Growth in business fixed investment was likely to remain sluggish for the time being, as corporate profits were expected to continue decreasing.

Private consumption had been relatively weak, mainly due to sluggish growth in household income and the increase in prices of energy and food. Sales of electrical appliances had continued to increase steadily. In July, sales of air conditioners and refrigerators were strong due to the extremely hot weather, and sales of flat-panel televisions and other products demand for which was partly associated with the Beijing Olympics had increased to some extent. New passenger-car registrations had been sluggish, partly due to high gasoline prices. Sales at department stores and supermarkets had remained relatively weak, although they temporarily picked up in July assisted partly by the extremely hot weather. As for services consumption, outlays for travel, especially overseas travel, had been weak recently against the background of further increases in fuel surcharges added to airfares, while growth in sales in the food service industry had continued to be sluggish. Consumer sentiment had become more cautious, mainly due to the rise in prices of energy and food. Growth in private consumption was likely to be sluggish for the time being, as household income was expected to remain more or less flat and prices were likely to continue rising.

Housing investment had been more or less flat. The number of housing starts, a leading indicator of housing investment, continued to pick up until January 2008 and had since been more or less flat. Housing investment was expected to be more or less flat for the time being, given the stalling of the recovery in housing starts.

Production had been relatively weak and, in light of developments in demand both at home and abroad, was expected to remain relatively weak for the time being. Inventories as a whole had been kept more or less in balance with shipments.

As for employment and income, growth in household income had recently been sluggish. The year-on-year rate of increase in nominal wages per worker had declined. Household income was projected to remain more or less level.

On the price front, commodity prices had fallen back. The three-month rate of increase in the domestic corporate goods price index (CGPI) had declined somewhat, due to the setback in commodity prices. The pace of increase in the CGPI was expected to slow for the time being. The year-on-year rate of increase in the CPI (excluding fresh food) was around 2.5 percent against the background of the increase in prices of energy and food. It was expected to remain at around the current level over the coming months but to moderate gradually thereafter.

2. Financial environment

The environment for corporate finance was accommodative on the whole. Credit demand in the private sector had been increasing moderately. Issuing conditions for CP and corporate bonds had been favorable as a whole, although they had tightened for firms with low credit ratings and in some industries. The lending attitudes of private banks had continued to be generally accommodative, and the amount outstanding of lending by private banks, notably to large firms, had been increasing, although that of lending to small firms had been below the previous year's level. Funding costs for firms had remained more or less unchanged. The financial positions of firms as a whole had continued to be favorable, but those of small firms and of firms in some industries had deteriorated. The year-on-year rate of growth in the money stock (M2) was in the range of 2-3 percent.

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

### A. Economic Developments

Members agreed on the following assessment of the current state of Japan's economy: economic growth had been sluggish against the backdrop of high energy and materials prices and weaker growth in exports; while growth would likely remain sluggish for the time being, the economy was unlikely to experience a significant downturn, as there was no excess in production capacity and labor, and was expected to return gradually onto a moderate growth path as commodity prices stabilized and overseas economies moved out of their deceleration phase.

Members agreed that, although overseas economies taken as a whole had continued to expand, the pace of growth was slowing and downside risks remained elevated, mainly reflecting the increasing tensions in global financial markets, sluggish growth in the U.S. economy, and a clearer slowdown in European and Asian economies.

Members shared the view that tensions in global financial markets had been increasing against the background of the recent developments among U.S. financial institutions. Many members expressed the view that although concerns about the financial soundness of U.S. and European financial institutions seemed to have eased temporarily following the release of the rescue package for the two GSEs, they were growing again mainly due to the failure of a major U.S. investment bank. On this point, some members mentioned that market liquidity had recently decreased substantially as market participants' aversion to risk had rapidly increased. One member added that financial stocks had dropped significantly and corporate bond spreads and credit default swap (CDS) premiums had widened. Some members said that attention should be paid to the possibility that U.S. and European financial institutions, which had so far strengthened their capital bases to make up for realized losses, might find it difficult to raise new capital for several reasons. First, amid a continuing fall in home prices, there were concerns that U.S. and European financial institutions might incur further losses. Second, investors who had given financial support to them by, for example, purchasing new stocks were suffering unrealized capital losses. And third, it was not clear what the future business model of U.S. and European financial institutions would be.

Members concurred that growth in the U.S. economy had remained sluggish. Some members expressed the view that deterioration in the housing market had not come to a halt as home prices continued to decline on the whole. One member, however, said that some housing-related indicators had started to suggest a slowdown in the deterioration in the housing market, and added that the rescue package for the two GSEs might have the effect of bringing down interest rates on residential mortgages. As for the outlook, many members said that for the time being the U.S. economy was likely to be negatively affected by factors such as the abatement of the effects of tax rebates, which previously boosted private consumption, and a more cautious stance among financial institutions on lending. One member, however, noted that there were signs of an improvement in consumer confidence reflecting the recent decline in crude oil prices and this might provide impetus to car purchases, for example. Based on these assessments, many members expressed the view that attention should be paid to the risk that the negative impact of the increasing tensions in global financial markets on economic activity would intensify, and also said that considerable uncertainty remained regarding when and how the negative feedback loop between financial markets and economic activity would diminish.

With regard to European economies, members shared the view that a slowdown in the economy of the euro area had become more evident. One member said that the U.K. economy had been decelerating as adjustments in the housing market continued, and that careful attention should be paid to the effectiveness of the recently launched government initiative aimed at supporting the housing market.

On Asian economies, members concurred that, while the pace of growth in the NIEs and ASEAN economies had decelerated mainly because exports continued to decelerate, China and India continued to show high growth. Some members said that in China, while inflationary pressures remained strong, the macroeconomic policy stance had shifted to stimulate economic growth recently as evidenced by, for example, a cut in renminbi benchmark lending rates by the People's Bank of China, and consequently future price developments there warranted close monitoring.

Regarding global price developments, members agreed that global inflationary pressures remained high although commodity prices had fallen back recently. A few members said that, although crude oil prices had been declining recently, they were unlikely to decline further to any great extent, because the prolonged rise reflected increased demand brought about by growth in emerging economies.

Members concurred that the pace of increase in Japan's exports had slowed, and that their growth was likely to remain only modest for the time being, due to the slowdown in overseas economies. One member said that future developments in exports to Asian economies warranted attention as the growth in these exports, which constituted a large proportion of Japan's overall exports, had started to slow.

With regard to domestic private demand, members agreed that business fixed investment had declined somewhat lately, as corporate profits had decreased mainly due to the earlier deterioration in the terms of trade, and that its growth was likely to remain sluggish for the time being. One member said that data in the *Financial Statements Statistics of Corporations by Industry, Quarterly* for the April-June quarter suggested that firms, particularly small ones, were restraining business fixed investment. Some members noted, however, that firms' capital stock did not seem to be excessive. Also, some members remarked that large firms had continued to exhibit a strongly positive attitude toward investment aimed at maintaining competitiveness through, for example, energy and resource saving, and this attitude was likely to underpin overall business fixed investment. A few of these members said, however, that careful attention should be paid to the possibility that this positive attitude might wane against the background of the recent decrease in corporate profits. Members agreed that the results of the September *Tankan* (Short-Term Economic Survey of Enterprises in Japan) needed to be studied to reassess the situation in the corporate sector including developments in fixed investment.

Members concurred that private consumption had been relatively weak, mainly due to sluggish growth in household income and the increase in prices of energy and food. Some members said that the strength in some sales indicators of goods and services for July was only a temporary phenomenon due to the extremely hot weather. Members concurred that growth in private consumption was likely to be sluggish for the time being, as it was likely that household income would remain more or less flat and that prices would continue rising.

As for employment and income, members shared the view that growth in household income had recently been sluggish and that it was likely to remain more or less level. One member said that attention should be paid to whether an increasing number of small firms, whose business conditions had been severe, might cut wages and dismiss workers amid the sluggish growth of the economy. A different member said that, if an employment adjustment became necessary, it was likely to be implemented more easily and quickly than in the past since the proportion of non-regular employees had increased, and this warranted attention.

Members concurred that housing investment had been more or less flat, and it was likely to remain so for the time being, given the stalling of the recovery in housing starts.

Members agreed that production was likely to remain relatively weak for the time being in light of developments in demand both at home and abroad. Some members said that, according to the projected figures and interviews with firms, production was likely to decrease in the July-September quarter for the third consecutive quarter. One of these members added that the recent consecutive decrease in production was the first since the IT bubble burst in 2001, but its pace was slower.

Members exchanged views regarding the effects on Japan's economy of the recent fall in prices of commodities, particularly crude oil. Many members said that given that the main cause of the current sluggish growth of the economy was the outflow of income due to the deterioration in the terms of trade, the setback in commodity prices, particularly crude oil prices, would provide impetus to domestic private demand through improvement in the terms of trade. A few of these members said that it would take time for such positive effects to appear, and that attention should be paid to the possibility that negative effects, such as those from a drop in exports, would be stronger in the short term, mainly due to the global economic slowdown that underlay the setback in commodity prices.

As for prices, members said that the three-month rate of increase in the CGPI had declined somewhat due to the setback in commodity prices, and the pace of increase was likely to slow for the time being.

Members noted that the year-on-year rate of increase in the CPI (excluding fresh food) was currently around 2.5 percent against the background of the increase in prices of energy and food, and concurred that the CPI inflation rate was likely to remain at around the current level over the coming months but to moderate gradually thereafter. Members exchanged views regarding the effects on general prices of the earlier rise in energy and materials prices. Many members said that, despite the continuing pass-through of the rise in energy and materials prices, there had been no signs of second-round effects to date, as was evidenced by developments in wages. One member said, however, that attention to inflationary risks should not be relaxed just because crude oil prices had been declining recently and there had been no signs of a wage-price spiral developing, since firms would continue to pass the earlier rise in energy and materials prices on to sales prices. A different member said that the CGPI by stage of demand indicated an acceleration in the year-on-year rate of increase in final goods prices, and this showed that the rise in energy and materials prices had been gradually passed on to prices downstream. In relation to this, among the items in the basket of the CPI, a few members noted -- in comparing developments in July with those of the previous month -- that items whose prices had risen outnumbered even more greatly those whose prices had declined. Based on these discussions, members concurred that due attention should continue to be paid to developments in prices, including factors affecting them such as the inflation expectations of households and the price-setting behavior of firms.

### B. Financial Developments

Members concurred that financial conditions in Japan remained accommodative on the whole. They also agreed that issuing conditions for CP and corporate bonds had been favorable as a whole, although they had tightened for firms with low credit ratings and in some industries, and that the lending attitudes of financial institutions had been generally accommodative. One member noted, however, that financial institutions' lending attitudes toward construction and real estate firms had become cautious, and this had led to the recent increase in the number of bankruptcies. A different member said that close monitoring was required on how the failure of a major U.S. investment bank and the subsequent disruptions in global financial markets affected the lending attitudes of financial institutions in Japan.

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

Based on the above discussions on economic and financial developments, members made an assessment in terms of <u>the first perspective</u>, that is to say, they assessed the most likely outlook for economic activity and prices. They agreed that the probability of Japan's economy returning onto a sustainable growth path with price stability was relatively high.

Members then made an assessment in terms of <u>the second perspective</u>, that is to say, they examined the risks that they considered most relevant to the conduct of monetary policy, including risks that had a longer time horizon than the first perspective. Regarding economic developments, members noted the following points: (1) tensions in global financial markets had been increasing reflecting the recent developments among U.S. financial institutions, and strains in U.S. and European money markets were intensifying again; (2) there were downside risks to the world economy, reflecting sluggish growth in the U.S. economy and a clearer slowdown in European and Asian economies; and (3) weaker income generation reflecting the earlier deterioration in the terms of trade could potentially weigh on domestic private demand. On this basis, members shared the view that, although the economy was under no pressure to adjust production capacity and labor, downside risks demanded attention. A few members commented in particular on the outlook for overseas economies that the risk-taking ability of U.S. and European financial institutions had been declining, and attention should therefore be paid to the downward pressure from the financial side due to, for example, the more severe lending attitude of those financial institutions. As for the outlook for Japan's economy, some members expressed the view that, although the main scenario that it would return onto a growth path remained intact, the possibility that it might do so later than expected should be borne in mind.

As for prices, members noted the following points: (1) global inflationary pressures remained high although commodity prices had fallen back recently; and (2) in Japan, there was a possibility that the inflation expectations of households and the price-setting behavior of firms might change, reflecting developments in energy and materials prices and the continuing price rises, which were unprecedented in recent years. They then agreed that it was necessary to continue to be mindful of upside risks to inflation. Some members said that, although commodity prices had fallen back recently, the possibility could not be ruled out that they might start rising again, given for example the growth in demand, especially demand from emerging economies, and concerns about geopolitical risks. One of these members expressed the view that attention should continue to be paid to inflationary risks, given that financial conditions had been accommodative worldwide.

Many members were of the opinion that, if the downside risks to the economy turned out to decrease, there would be an increased risk that prolonging the period of accommodative financial conditions would lead to swings in economic activity and prices.

Based on the above discussions, members agreed that, in conducting monetary policy, the Bank should continue to pay attention to both downside risks to economic growth and upside risks to inflation.

On <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that, given the assessment of economic activity and prices described above, it would be appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0.5 percent.

Members concurred that the following thinking on <u>the monetary policy stance for</u>

the future remained unchanged: the Bank would carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections materializing as well as factors posing upside or downside risks, and would conduct monetary policy in an accordingly flexible manner. On this basis, they shared the view that it was becoming more important for the Bank to continue to strive to ensure smooth settlement of funds and maintain market stability, taking into account the recent developments among U.S. financial institutions and their impact. In relation to this view, one member added that, in the current situation, the Bank's most important task as a central bank was to maintain stability in financial markets by conducting appropriate money market operations.

## IV. Remarks by Government Representatives

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

(1) Amid continuing strains resulting from difficulties in U.S. financial institutions, the financial authorities of major countries, including Japan, had been cooperating closely and taking appropriate actions, and it was important to maintain this close cooperation. The effects of heightened geopolitical risks on the world economy continued to warrant attention. To respond to the situation, the Ministry of Finance would monitor carefully developments in financial markets both at home and abroad as well as their effects on the Japanese economy and the world economy as a whole. The government would like the Bank to continue to react appropriately to ensure stability in financial markets.

(2) Japan's economy was weakening recently against the background of the slowdown in the global economy, including the U.S. economy, and was expected to remain weak for the time being. Prices, especially those related to energy and food, were rising, and this was reflected in both domestic corporate goods prices and consumer prices. The recent drop in commodity prices such as crude oil prices in the futures markets would affect overall price developments in the near future.

(3) The government would like the Bank to continue to support the economy from the financial side taking into account the economic situation.

(4) The government would also like the Bank to continue to clearly explain to the public and market participants its view on economic activity and its thinking on the conduct of monetary policy.

The representative from the Cabinet Office made the following remarks.

(1) Japan's economy was weakening recently, mainly because exports were weakening and production was on a gradual downward trend. The economy was likely to remain weak for the time being, and it might weaken further, depending on future developments in crude oil prices and the effects of the strains in global financial markets triggered by the recent failure of a U.S. investment bank. The GDP deflator continued to decrease, and close attention should therefore be paid to developments in prices, together with those in economic activity.

(2) In view of the impact of the global economic slowdown and the worldwide surge in prices of resources and food, the government released the "Comprehensive Immediate Policy Package" on August 29, 2008.

(3) In order to ensure sustainable economic growth led by private demand and achieve a stable inflation rate, it was important for the government and the Bank to implement their policies based on the shared basic perspective on macroeconomic management.

(4) The government would like to request the Bank to implement monetary policy in a timely and appropriate manner that was consistent with the government's policy efforts and its outlook for the economy, and to firmly support the economy from the financial side in view of downside risks to the outlook for the economy. The government would also like the Bank to continue to react appropriately to ensure smooth settlement of funds and maintain market stability, given the strains in global financial markets.

## V. Votes

Based on the above discussions, members agreed that it was appropriate to maintain the current guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at around 0.5 percent.

To reflect this view, the chairman formulated the following proposal and put it to the 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 0.5 percent.

2. A public statement will be decided separately.

Votes for the proposal: Mr. M. Shirakawa, Mr. K. G. Nishimura, Ms. M. Suda, Mr. A. Mizuno, Mr. T. Noda, Mr. S. Nakamura, and Mr. H. Kamezaki.
Votes against the proposal: None.

## VI. Discussion on the Statement on Monetary Policy

Members discussed the "Statement on Monetary Policy," and put it to the 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 18 and 19, 2008 for release on September 22, 2008.

Attachment

September 17, 2008

Bank of Japan

**Statement on Monetary Policy**

1. At the Monetary Policy Meeting held today, the Bank of Japan decided, by a unanimous vote,[Note] 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 0.5 percent.

2. Economic growth has been sluggish against the backdrop of high energy and materials prices and weaker growth in exports. While growth will likely remain sluggish for the time being, it is expected to return gradually onto a moderate growth path as commodity prices stabilize and overseas economies move out of their deceleration phase. The CPI inflation rate (excluding fresh food) is currently around 2.5 percent, its highest since the first half of 1990s, due to increased prices of energy and food. It is expected to remain at around this level over the coming months but to moderate gradually thereafter. Thus it is likely that the economy will return onto a sustainable growth path with price stability.

3. With regard to risk factors, tensions in global financial markets have increased and there are downside risks to the world economy. In addition, weaker income generation reflecting deterioration in the terms of trade could potentially weigh on

[Note] Voting for the action: Mr. M. Shirakawa, Mr. K. G. Nishimura, Ms. M. Suda, Mr. A. Mizuno, Mr. T. Noda, Mr. S. Nakamura, and Mr. H. Kamezaki.
Voting against the action: None.

domestic private demand. Although the economy is under no pressure to adjust production capacity and labor, these downside risks to the economy demand attention. Turning to prices, global inflationary pressures remain high. In Japan, it is necessary to be mindful of upside risks due to changes in the inflation expectations of households and the price-setting behavior of firms in addition to developments in energy and materials prices. Meanwhile, if the downside risks to the economy turn out to decrease, there will be an increased risk that prolonging the period of accommodative financial conditions will lead to swings in economic activity and prices.

4. The Bank will carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections as well as factors posing upside or downside risks, and will implement its policies in an accordingly flexible manner.

While Japan's money market has been functioning well, the Bank will continue to strive to ensure smooth settlement of funds and maintain market stability taking into account the recent developments among U.S. financial institutions and their impact.