Not to be released until 8:50 a.m. Japan Standard Time on Thursday, November 27, 2008.

November 27, 2008

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 31, 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 Friday, October 31, 2008, from 8:30 a.m. to 1:53 p.m.[1]

Policy Board Members Present

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

Mr. H. Yamaguchi, Deputy Governor of the Bank of Japan

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

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

Mr. Y. Miyazawa, Senior Vice Minister, Cabinet Office

Reporting Staff

Mr. A. Horii, Executive Director (Assistant Governor)

Mr. K. Ido, Executive Director

Mr. K. Yamamoto, Executive Director

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

Mr. M. Ayuse, Associate Director-General, Monetary Affairs Department[2]

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

Mr. T. Kato, Senior Economist, 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 November 20 and 21, 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. M. Ayuse was present from 8:30 a.m. to 8:53 a.m.

Mr. E. Maeda, Associate Director-General, Research and Statistics Department[3]

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. Sakamoto, Director, Head, Monetary Operations Planning, Monetary Affairs Department[4]

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

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

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[3] Mr. E. Maeda was present from 9:16 a.m. to 1:53 p.m.

[4] Mr. T. Sakamoto was present from 8:30 a.m. to 8:53 a.m.

I. Staff Proposal Relating to Review of the Bank's Reserve System

Based on the announcement released on October 8, 2008, the staff had been reviewing the Bank's reserve system as a step to further enhance the effectiveness of money market operations in order to ensure stability in financial markets in Japan. Given the results of the review, the staff concluded that, in the Bank's continuing flexible provision of sufficient liquidity, it would be appropriate for the Bank to introduce a temporary measure under which the Bank paid interest on excess reserve balances, in order to prevent the uncollateralized overnight call rate from falling well below its targeted level and to facilitate money market operations. The staff therefore proposed that the Bank establish the Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds.

II. 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 meetings on October 6 and 7, 2008 and October 14, and as a result, the uncollateralized overnight call rate had been at around 0.5 percent.[6] On October 10, the weighted average of the uncollateralized overnight call rate rose to 0.585 percent, as funds transactions decreased mainly in anticipation of the introduction of next-generation real-time gross settlement (RTGS-XG) into the Bank of Japan Financial Network System (BOJ-NET) Funds Transfer System on the next business day. On October 15, the last day of the reserve maintenance period, it fell to 0.348 percent, as financial institutions had satisfied most of their reserve requirements and there was a growing sense of abundance of liquidity in the money market.

In line with measures regarding money market operations to ensure stability in the financial markets decided at the previous meeting, the Bank provided sufficient funds maturing over the year-end and actively conducted Japanese government securities and CP repo operations. In addition, the Bank started to conduct U.S. dollar funds-supplying

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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.

operations whereby funds were provided at a fixed rate set for each operation against pooled collateral.

B. Recent Developments in Financial Markets

Japan's money market had remained nervous reflecting disruptions in global financial markets. The general collateral (GC) repo rate had remained relatively high due to lenders' cautious stance on trading. Euroyen rates remained at an elevated level as the transaction volume decreased.

Japanese stock prices had dropped considerably amid growing concerns about the stability of the global financial system and about a further slowdown of the world economy as well as heightening concerns about deterioration in business performance of Japanese exporters reflecting the ongoing appreciation of the yen. The Nikkei 225 Stock Average had been moving at around 9,000 yen recently. Long-term interest rates in Japan had moved within a relatively narrow range, and had recently been in the 1.40-1.50 percent range.

The yen was bought back rapidly, and had recently been traded in the range of 97-100 yen to the U.S. dollar.

C. Overseas Economic and Financial Developments

Growth in the U.S. economy had remained sluggish, and the downward pressure on the economy had grown. A substantial decline in housing investment continued, and home prices continued to fall. Private consumption, after remaining more or less unchanged, had started to show signs of a decrease. The deceleration in business fixed investment had also continued. In this situation, industrial production had been on a downward trend and the pace of decrease in the number of employees had been accelerating. The spending behavior of firms and households had become more cautious, as funding conditions for firms and households had deteriorated further and the level of uncertainty about the outlook for the economy had increased. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items had started to decline, due to a leveling-off of increases in energy and food prices.

The economy of the euro area had been sluggish. The slowdown in business fixed investment had become more evident, and the pace of increase in exports had also slowed. Private consumption had decreased. In this situation, production had been on a declining trend. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) had started to decline, due to a leveling-off of increases in energy and food prices. The U.K. economy had been sluggish, as significant adjustments in the housing market had continued and private consumption had been more or less flat. Moreover, the downward pressure on the economy had grown rapidly in a situation where funding conditions for firms and households had deteriorated.

Among Asian economies, China and India continued to show high growth, although the growth was slowing somewhat. The pace of growth in the NIEs and the ASEAN economies had decelerated. As for prices, the year-on-year rate of increase in the CPI for all items had started to decline in many Asian economies, due to a leveling-off of increases in energy and food prices.

With regard to global financial markets, due to a series of financial system stabilization measures taken by governments and central banks, money markets had improved slightly as seen in, for example, the fact that Treasury-Eurodollar (TED) spreads had started to narrow, although they remained at a high level. Credit markets, however, had not improved: for example, credit spreads on corporate bonds had widened and new funding of firms had been low. U.S. and European stock prices had declined sharply as concerns about economic deterioration had heightened due to relatively weak economic indicators. U.S. and European long-term interest rates had swung widely due to the persistent concern about a possible increase in the issuance of government securities resulting from the introduction of financial system stabilization measures and to concerns about economic deterioration.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had leveled off. Real exports showed a small increase in the July-September quarter from the previous quarter, after dropping considerably in the April-June quarter. Exports were likely to be relatively weak for the time being, taking into account the effects of the slowdown in overseas economies and the appreciation of the yen.

In the corporate sector, business fixed investment had declined, mainly due to the decrease in corporate profits. Machinery orders, which had been more or less flat at a high level until the April-June quarter, dropped in July and August in a wide range of industries. The slowdown in business fixed investment had become more evident, as seen in the fact that many indicators relating to it had been weak.

With regard to the household sector, private consumption had been relatively weak, mainly due to sluggish growth in household income and the increase in prices of energy and food. Consumer sentiment had also become more cautious.

Production had continued to decrease. The index of production declined in the July-September quarter for the third consecutive quarter. Production was likely to decrease at a faster pace in the October-December quarter, given the projected figures for October and November and anecdotal information from firms.

On the price front, the three-month rate of increase in the domestic corporate goods price index (CGPI) had declined rapidly, due to the setback in commodity prices. The year-on-year rate of increase in the CPI (excluding fresh food) was likely to decline gradually reflecting developments in prices of energy and food, although it remained relatively high to date.

2. Financial environment

The worsening in funding conditions in Japan's capital markets had become more evident as seen in the fact that issuance spreads on CP had widened rapidly and issuance of corporate bonds had been sluggish due to increased risk aversion among investors reflecting disruptions in global financial markets. The year-on-year rate of increase in lending by private banks had declined somewhat, although the amount outstanding had continued to increase. These developments seemed to suggest that (1) business performance of small firms had deteriorated; (2) financial institutions had become more cautious in extending credit to firms in specific industries, for example, construction and real estate firms and consumer finance companies, as well as to small firms; and (3) demand for working capital had leveled off recently, especially among large firms.

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

A. Economic Developments

Members agreed that both financial and economic adjustments in the world economy stemming from financial crises in the United States and Europe had further increased in severity recently.

Members shared the view that global financial markets remained under intense strain as a whole, although an improving trend was seen in some money market indicators. One member expressed the view that developments in global financial markets remained highly uncertain, as credit default swap (CDS) premiums had exceeded their levels at the time of the failure of Lehman Brothers Holdings Inc. while stock prices had fallen worldwide, particularly in the United States and Europe. Some members noted that effects of financial market turmoil in industrialized economies had spread worldwide, especially to emerging economies.

Members concurred that growth in the U.S. economy had remained sluggish and the downward pressure on the economy had grown. Some members expressed the opinion that adjustments in the housing market had continued as seen in the continued decline in home prices, and the housing market showed no signs of bottoming out yet. One member said that an inter-regional negative feedback loop, in which the slowdown in economic activity in the United States and Europe affected emerging economies and then these in turn affected the U.S. and European economies, might have started to operate.

On the current state of Japan's economy, members agreed that economic activity had been increasingly sluggish due to the effects of earlier increases in energy and materials prices and the leveling-off of exports.

Members concurred that exports had leveled off against the background of the slowdown in overseas economies, particularly in the United States and Europe. One member expressed the view that, in a situation where exports to the United States had declined for four consecutive quarters and the pace of growth in overseas economies had been slowing as a whole, it was highly unlikely that the decrease in exports to the United States would be offset by an increase in exports to other regions. A different member said that the future effects of the appreciation of the yen also warranted attention.

With regard to the corporate sector, members agreed that business fixed investment had declined, mainly due to the decrease in corporate profits. A few members noted that the slowdown in machinery orders had become more evident as seen in a drop in a wide range of industries. One member expressed the view that the deterioration in the terms of trade had finally come to a halt, but it would take time for positive effects of this to appear.

As for the household sector, 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.

Members agreed that production had continued to decrease. Some members expressed the view that it was likely to decrease at a faster pace in the October-December quarter, given the projected figures and anecdotal information from firms. Some members said that production in many industries, such as transportation equipment, iron and steel, and electronic parts and devices, was projected to decline.

As for prices, members said that the three-month rate of increase in the CGPI had declined rapidly, due to the setback in commodity prices.

Members noted that the year-on-year rate of increase in the CPI (excluding fresh food) was likely to decline gradually reflecting the leveling-off of increases in prices of energy and food, although it remained relatively high to date.

B. Financial Developments

Members agreed on the following assessment of financial conditions in Japan: liquidity pressures remained comparatively low and credit spreads in the financial markets generally narrow relative to U.S. and European markets; however, the influence of the turmoil in global financial markets had recently been emerging in Japanese financial markets as could be seen in nervous conditions in the money market and significant declines in stock prices. A few members noted that investors had become increasingly risk averse reflecting disruptions in global financial markets, as the significant widening of issuance spreads on CP and the continued cancellations and postponements of corporate bond issuance showed, and that future developments warranted close monitoring. A different member expressed the view that conditions for firms to carry out funding in the capital markets through CP had deteriorated and firms had increased their dependence on indirect financing, but financial institutions' lending attitudes had become severe and financial conditions had become less accommodative.

C. Outlook for Economic Activity and Prices

With regard to the outlook for economic activity and prices, members agreed on the following assessment: (1) the increased sluggishness in economic activity would likely remain until around the middle of fiscal 2009; and (2) thereafter, the growth rate was likely to pick up gradually, as the effects of earlier increases in energy and materials prices abated and overseas economies moved out of their deceleration phase, although the timing was likely to be sometime after the middle of fiscal 2009.

As for prices, members agreed that the pace of increase in the CGPI would largely depend on developments in the prices of commodities such as crude oil and on exchange rates, but that the CGPI was likely to stabilize so long as commodity prices did not start to surge again. They also shared the view that the rate of increase in the CPI (excluding fresh food) was likely to decline gradually, as prices of energy and food stabilized with the output gap remaining negative and wages weak, while medium-term inflation expectations were likely to remain stable.

Members shared the view that upside and downside risks to the above outlook were as follows. In relation to economic activity, they were (1) the ongoing financial crises in the United States and Europe and their impact, (2) developments in emerging economies and commodity-exporting countries, (3) developments in energy and materials prices, (4) firms' expectations of future growth, and (5) developments in financial conditions. In relation to the outlook for prices, they were (1) deviation of inflation caused by the changes in economic activity, (2) changes in the inflation expectations of households and the price-setting behavior of firms, and (3) developments in import prices.

As for the ongoing financial crises in the United States and Europe and their impact, members concurred that, if strains in financial markets intensified further despite the various measures taken by the authorities, the risk-taking capacity of financial institutions and investors might decline and this could result in a worsening negative feedback loop between financial markets and economic activity, causing lower economic growth especially in the United States and Europe. A few members expressed the view that overseas economies were unlikely to recover in the short run, given that adjustments in the U.S. housing market, which had caused financial system disruptions in the United States and Europe, had not made progress and a negative feedback loop was already operating between financial markets and economic activity. One of these members commented that one of the long-term issues facing the world economy that warranted attention was how adjustments in excessive consumption and associated excesses in debt in the United States would progress.

Regarding developments in energy and materials prices, a few members said that there was a risk that commodity prices might surge again in the medium to long term, given the possibility that the world economy might expand at a higher-than-sustainable rate, and the inefficient use of natural resources in emerging economies. One of these members noted that commodity prices had been increasingly volatile due to changes in global supply-demand structure, and attention should therefore be paid to the considerable risk not only of their deviation either upward or downward, but also in terms of the degree of deviation. A different member commented that the recent setback in commodity prices would support domestic demand by improving the terms of trade, but as it was caused by the slowdown in the world economy, it should be borne in mind that a decrease in Japan's exports would precede the effects of improvement in the terms of trade.

As for developments in financial conditions, members agreed that there was a possibility that, if strains in global financial markets should increase further, pressures acting to depress economic activity from the financial side might become more marked. One member said that financial institutions had recently started to be aware of their capital constraints due to the depreciation of securities and the increase in credit costs, and therefore, financial conditions had been shifting to a tightening. A different member, however, commented that, from a longer-term perspective, attention should continue to be paid to the risk that accommodative financial conditions might lead to larger swings in economic and financial activity as well as in prices.

In relation to the outlook for prices, members concurred that there were considerable uncertainties attending inflation that could cause it to deviate either upward or downward from the projection, but the upside risks to prices had decreased compared with the past. One member, however, said that upside risks to prices continued to require attention, while noting the following reasons. First, in terms of the CPI, both for all items and for all items less food and energy, items whose prices had risen outnumbered those whose prices had declined, and this suggested possible changes in the price-setting behavior of firms. And second, there was a possibility that consumers might be increasingly accepting the price rises partly due to heightening concerns about food safety.

IV. 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 the first perspective, that is to say, they assessed the most likely outlook for economic activity and prices through fiscal 2010. They agreed that Japan's economy, in the longer run, was most likely to return onto a path of sustainable growth with price stability. They shared the view, however, that this outlook was largely dependent on the future course of the world economy. They continued that given recent developments in the world economy and global financial markets, it needed to be noted not only that it would take some time for the world economy to make the requisite adjustments and for the necessary conditions for Japan's economic recovery to be satisfied, but also that the level of uncertainty in the outlook had increased. In this regard, one member expressed the view that in a situation where the environment surrounding Japan's economic activity and prices was subject to a significant level of uncertainty, the Bank should be careful not to cause speculation among market participants regarding the timing of a policy change when expressing a view with regard to when the economic growth rate might gradually start to pick up.

Members then made an assessment in terms of the second perspective, 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 activity, members shared the view that the risks that demanded attention were the increasing downside risks to the economy stemming from uncertainties regarding future developments in global financial markets, the U.S. and European financial systems, and overseas economies. They concurred that it should also be noted that, if there should be an increase in the severity of the lending attitudes of Japanese financial institutions, there would be a risk of a downward pressure also being exerted on Japan's economic activity from the financial side. As for prices, members shared the view that although attention should be paid to upside risks stemming from further increases in energy and materials prices as well as changes in consumers' inflation expectations and the price-setting behavior of firms, these risks had decreased compared with the past. They agreed that there was also a possibility that the rate of increase in prices would decline more than expected, if downward risks to the economy materialized or commodity prices fell further.

As for the monetary policy stance for the future, given the assessment of economic activity and prices described above, members concurred that the following thinking 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 appropriately. They agreed that, at the current juncture, particularly close attention should be paid to the risk of downward deviation in economic activity due to developments in the U.S. and European financial systems and global financial markets as well as their subsequent impact on economic activity. They also agreed that the Bank would do its utmost to ensure market stability by conducting appropriate money market operations. One member said that stability in financial markets was vital for low interest rates to produce their maximal monetary easing effect.

On the guideline for money market operations for the intermeeting period ahead, one member expressed the view that 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. Most members, however, were of the view that it would be appropriate to lower the Bank's target for the uncollateralized overnight call rate, the policy interest rate. These members noted that the increased sluggishness in Japan's economic activity would likely remain over the next several quarters and, as for risks to economic activity, downside risks were increasing, and said that the policy interest rate should be lowered to maintain accommodative financial conditions.

Members agreed that the level to which the policy interest rate was reduced as well as the spreads between the policy interest rate and the rates applied to the complementary lending and deposit facilities should be set so as not to impair the proper functioning of the market mechanism in the money market and that therefore they should discuss the matter thoroughly in order to ensure that they reached an appropriate decision on these rates. They then discussed the appropriate size of an interest rate reduction. Some members expressed the view that a reduction of 25 basis points in the policy interest rate would be adequate. These members explained that the Bank should attach more importance to the fact that market participants were strongly aware that the Bank had often adjusted the policy interest rate by 25 basis points in the past. A few of these members said that in terms of the impact on the functioning of the market mechanism, there was no great difference between a reduction of 20 basis points and 25 basis points. Against this view, some members said that in any further reduction of a policy interest rate that had already been reduced to an extremely low level, careful consideration should be given not only to the positive effects of monetary easing, but also to possible adverse effects that might impair the proper functioning of the market mechanism in the money market and impede the flow of funds. These members noted that, particularly in the current situation where considerable deterioration in the functioning of the market mechanism could be observed, the possible adverse effects were becoming more important. They said that the policy interest rate should therefore be reduced by a smaller margin of 20 basis points, in order to clearly show the Bank's concern for the need to maintain the proper functioning of the market mechanism. One of these members said that, in reducing the policy interest rate, even a difference of 5 basis points had an effect that could not be ignored. A different member added that, in this unprecedented situation of disruptions in global financial markets, there was no need to be swayed by the fact that the Bank had often adjusted the policy interest rate by 25 basis points in the past.

Members concurred that to ensure stability in the financial markets, it would be appropriate to introduce the complementary deposit facility in order to further facilitate the provision of sufficient liquidity over the calendar and fiscal year-ends. One member expressed the view that even after this facility was introduced, it was important for the Bank to continue to conduct money market operations in a flexible manner. As for the rates applied to the complementary lending and deposit facilities, members exchanged views regarding what would be an adequate level of the spreads between each of these rates and the policy interest rate. Many members expressed the view that, in discussing the most suitable level of the spread, it was important to consider both the impact of having wide spreads -- which might make market rates difficult to control -- and that of having narrow spreads -- which might impair the proper functioning of the market mechanism, with market activity being reduced to low levels by a decrease in extension of credit by financial institutions. One member said that although attention should be paid to the possibility that the proper functioning of the market mechanism might be impaired, setting narrow spreads of, for example, 15 basis points might be acceptable given that ensuring market stability was the current priority and the complementary deposit facility was only a temporary measure. A different member expressed the view that the spread between the rate applied to the complementary lending facility and the policy interest rate should be kept at 25 basis points and the spread between the rate applied to the complementary deposit facility and the policy interest rate should be set at 15 basis points, since narrowing the latter spread to that extent would not greatly affect market activity, pointing to data on the recent dispersion of the rate for uncollateralized overnight call transactions. Another member said that once the transaction volume started to decrease in the market, the pace of decrease tended to accelerate, and thus a relatively wide spread should be set at the time when the complementary deposit facility was introduced. A different member said that the rate applied to the complementary deposit facility should be set at a level higher than 0 percent to maintain the proper functioning of the market mechanism. Based on the above discussions, some members expressed the view that both spreads should be set at 20 basis points.

V. Submission of Policy Proposals on the Guideline for Money Market Operations

Based on the above discussions, some members expressed the view that it would be appropriate to lower the Bank's target for the uncollateralized overnight call rate from around 0.5 percent to around 0.3 percent.

Some other members, however, said that they would like to propose that the Bank should lower its target for the uncollateralized overnight call rate to around 0.25 percent.

As a result, the following proposals were submitted.

The chairman submitted the following proposal.

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, effective immediately from the announcement of the decision.

> The Bank of Japan will encourage the uncollateralized overnight call rate to be at around 0.3 percent.

2. A public statement will be decided separately.

Ms. M. Suda, Mr. S. Nakamura, and Mr. H. Kamezaki proposed the following guideline for money market operations for the intermeeting period ahead:

> The Bank of Japan will encourage the uncollateralized overnight call rate to be at around 0.25 percent.

VI. Remarks by Government Representatives

Following the staff reports on economic and financial developments, the representative from the Ministry of Finance made the following remarks.

(1) On October 30, 2008, the government and the ruling parties decided a new set of economic measures, "Measures to Counter Difficulties in People's Daily Lives," which put emphasis on the three objectives of (1) enabling people to deal with difficulties in their daily lives, (2) stabilizing and bolstering the financial markets and the economy, and (3) activating the latent strengths of the nation's regions. The government would take all available measures to address the recent severe economic and financial conditions; for instance, it would implement fiscal measures, revise the tax system, and improve financial legislation.

The representative from the Cabinet Office made the following remarks.

(1) On October 30, 2008, the government decided the new set of economic measures, "Measures to Counter Difficulties in People's Daily Lives," following the release of the "Comprehensive Immediate Policy Package." The government would continue its efforts to ensure the stability of the financial markets and underpin the economy given the recent severe economic and financial conditions by swiftly implementing these measures.

Following the submission of policy proposals on the guideline for money market operations, the representative from the Ministry of Finance made the following remarks.

(1) Amid the global economic slowdown, the downward trend of Japan's economy was likely to continue for the time being. As for developments in consumer and other

prices, they were expected to be influenced by the recent downtrend in the prices of commodities, particularly crude oil futures.

(2) Given this situation, as the representative of the Ministry of Finance had said earlier, on October 30, 2008 the government and the ruling parties formulated the "Measures to Counter Difficulties in People's Daily Lives."

(3) The government would like the Bank to conduct monetary policy in an appropriate and flexible manner so as to support the economy from the financial side, taking account of the current economic and financial conditions.

(4) Regarding introduction of a complementary deposit facility, the government would like the Bank to explain clearly to the public that the purpose of introducing the facility would be to further enhance smooth and flexible provision of liquidity. The government would also like the Bank to provide liquidity in a more flexible manner.

The representative from the Cabinet Office made the following remarks.

(1) Japan's economy had weakened further as evidenced by the fact that production was decreasing, and it appeared to be in a contraction phase. The downward trend of the economy was likely to continue for the time being amid the global economic slowdown. There was also a risk that the economic situation in Japan would become severer due to the worsening financial crises in the United States and Europe. As for prices, the year-on-year rate of increase in consumer prices remained moderate, and upward pressure on prices in general had not noticeably increased, as seen in a pause in the improvement in the output gap.

(2) Proposals to reduce the policy interest rate had been submitted. The government welcomed the measure proposed at this meeting as an appropriate response to address the current severe economic and financial conditions. The measure was also consistent with the government's basic thinking that international cooperation was important.

(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 continue to conduct their policies based on the shared basic perspective on macroeconomic management, paying close attention to economic and financial developments at home and abroad.

(4) Amid severe economic and financial conditions at home and abroad, the government would like to request the Bank to continue to make efforts to ensure stability in the financial markets, and to conduct monetary policy in an appropriate and flexible manner so as to support the economy from the financial side in view of the government's efforts to implement the "Measures to Counter Difficulties in People's Daily Lives" and structural reforms.

VII. Votes

A. Vote on the Guideline for Money Market Operations

The proposals, submitted by the chairman, and by the three members, Ms. M. Suda, Mr. S. Nakamura, and Mr. H. Kamezaki, were put to the vote, the three members' proposal first, then the chairman's proposal.

Ms. M. Suda, Mr. S. Nakamura, and Mr. H. Kamezaki's policy proposal on the guideline for money market operations was defeated by a majority vote.

Votes for the proposal: Ms. M. Suda, Mr. S. Nakamura, and Mr. H. Kamezaki.
Votes against the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. A. Mizuno, and Mr. T. Noda.

The vote on the chairman's policy proposal on the guideline for money market operations was equally split, and the chairman made the final decision, as stipulated in Article 18, paragraph 2 of the Bank of Japan Act of 1997, approving the proposal.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, and Mr. T. Noda.
Votes against the proposal: Ms. M. Suda, Mr. A. Mizuno, Mr. S. Nakamura, and Mr. H. Kamezaki.

Ms. M. Suda dissented from the chairman's policy proposal for the following reasons. First, it was not convincing to explain that the Bank needed to change the size of policy interest rate adjustment from the conventional 25 basis points to 20 basis points for the sole reason that the former would impair the proper functioning of the market mechanism. And second, such a policy action would be likely to increase uncertainty regarding the size of future policy interest rate adjustments by the Bank.

Mr. A. Mizuno dissented from the proposal for the following reasons. First, the current policy priority of the Bank was to implement measures to enhance the smooth flow of funds, in view of the current situation in CP and GC repo markets, rather than to reduce the policy interest rate. Second, the Policy Board should have further discussions about measures to be implemented if the economic situation worsened further. Third, given the decline in the functioning of CP and corporate bond markets, the transmission mechanism through which a policy interest rate reduction would influence economic activity was uncertain. Fourth, despite the policy intention, money market operations to provide ample liquidity could become more difficult, since market participants were likely to expect additional policy interest rate reductions, which would exert downward pressure on the call rate. And fifth, it had been only a short while since the Bank had decided, by a unanimous vote, to maintain the guideline for money market operations.

Mr. S. Nakamura dissented from the proposal for the following reason. Since the proper functioning of the market mechanism would be maintained even if the Bank reduced the policy interest rate by 25 basis points, it would be appropriate to adjust the policy interest rate by 25 basis points as in the past.

Mr. H. Kamezaki dissented from the proposal for the following reason. When reducing the policy interest rate, the Bank should show market participants and economic entities that it was determined to prevent the materialization of downside risks to the economy and support economic growth, but a reduction of the policy interest rate by a smaller margin of 20 basis points might convey the impression that the Bank was holding back from taking decisive policy action or that there was room for further policy interest rate reductions.

Members agreed that it would be appropriate to make public the reasons for some members' dissent from the chairman's policy proposal on the guideline for money market operations today rather than later with the release of the minutes of this meeting. Although there was an opinion that there should be careful discussion about whether the reasons for the dissent should be released with the policy statement, members finally concurred that, in order to gain the understanding of market participants, it would be appropriate that the chairman give the reasons in full at the press conference following this meeting.

B. Vote on the Establishment of the Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds

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

C. Vote on a Change in the Basic Discount Rate and the Basic Loan Rate and the Setting of the Interest Rate to Be Applied under the Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds

To reflect the view of members, the chairman formulated the following two policy proposals and put them to the vote: (1) a change in the basic discount rate and the basic loan rate; and (2) setting of the interest rate to be applied under the Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds.

The Chairman's Policy Proposal on a Change in the Basic Discount Rate and the Basic Loan Rate:

1. The basic discount rate for discounting of bills pursuant to Article 33, paragraph 1, item (i) of the Bank of Japan Act and the basic loan rate for loans made pursuant to Article 33, paragraph 1, item (ii) of the Act will be as follows, effective immediately from the announcement of the decision.

    The basic discount rate and the basic loan rate will be changed to 0.5 percent.

2. A public statement will be decided separately.

The Chairman's Policy Proposal on the Setting of the Interest Rate to Be Applied to the Complementary Deposit Facility:

1. The spread between the uncollateralized overnight call rate target decided as the guideline for money market operations and the interest rate to be applied under the Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds will be as follows.

The spread will be 0.2 percentage point.

2. A public statement will be decided separately.

The chairman's policy proposal on a change in the basic discount rate and the basic loan rate was approved by a unanimous vote.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, 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.

The chairman's policy proposal on the setting of the interest rate to be applied to the complementary deposit facility was approved by a unanimous vote.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, 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.

VIII. Discussion on the Public Statement on Monetary Policy Decisions

Members discussed the statement "On Monetary Policy Decisions," 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 1).

IX. Discussion on the *Outlook for Economic Activity and Prices*

Members discussed the draft of the *Outlook for Economic Activity and Prices* (consisting of "The Bank's View" and "The Background"), and put "The Bank's View" to the vote. The Policy Board decided, by a unanimous vote, the text of "The Bank's View." It was confirmed that "The Bank's View" would be published on October 31, 2008 and the whole report on November 4, 2008.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, 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.

X. Approval of the Minutes of the Monetary Policy Meetings

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of September 29, 2008 and October 6 and 7 for release on November 6, 2008.

Attachment 1

October 31, 2008

Bank of Japan

On Monetary Policy Decisions

1. Adjustments in the world economy stemming from financial crises in the United States and Europe have further increased in severity. Under these circumstances, increased sluggishness in Japan's economic activity will likely remain over the next several quarters with exports leveling off and the effects of earlier increases in energy and materials prices persisting. As for prices, consumer price inflation is likely to decline gradually reflecting the recent fall in commodity prices, although it remains relatively high to date. The outlook for economic activity and prices is attended by increased downside risks to economic activity but also by decreased upside risks to inflation relative to the recent past.

2. The Bank, while strains in global financial markets have mounted, has undertaken various prompt and decisive measures in providing liquidity, bearing in mind that the most important contribution a central bank can make in this situation is to ensure stability in financial markets. In addition, at the Monetary Policy Meeting held today, the Bank judged that a reduction in policy interest rates and a further increase in the flexibility of money market operations were necessary to maintain accommodative financial conditions. Respective decisions are as follows.

   (1) Change in the guideline for money market operations (decided by the chairman's final decision after a split vote[Note 1])

[Note 1] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, and Mr. T. Noda.
Voting against the action: Ms. M. Suda, Mr. A. Mizuno, Mr. S. Nakamura, and Mr. H. Kamezaki.

Lower the Bank's target for the uncollateralized overnight call rate by 20 basis points and encourage it to remain at around 0.3 percent (effective immediately) (Attachment 2).

(2) Change in the basic loan rate[Note 2] (decided by a unanimous vote[Note 3])

Lower the basic loan rate applicable under the complementary lending facility by 25 basis points to 0.5 percent (effective immediately).

(3) Introduction of Complementary Deposit Facility (decided by a unanimous vote[Note 4])

To ensure stability in money markets, a temporary measure will be introduced to pay interest on excess reserve balances in order to further facilitate the provisioning of sufficient liquidity toward the year-end and the fiscal year-end. This measure will be effective from the November reserve maintenance period to the March 2009 reserve maintenance period, and the interest rate applied will be 0.1 percent (Attachment 3).

3. Currently, the world economy is undergoing a process of correcting various imbalances that accumulated during the past several years, and this will likely weigh on economic activity for some time to come. Against this background, it will likely take some time for the necessary conditions for Japan's economic recovery to be satisfied. The Bank will continue to do its utmost to facilitate a return of Japan's economy to its sustainable growth path with price stability through maintaining accommodative financial conditions.

[Note 2] The basic loan rate is stipulated in Article 15, paragraph 1, item (ii) of the Bank of Japan Act. The basic discount rate in item (i) in the same paragraph is also set at 0.5 percent (discounting of bills has currently been suspended).

[Note 3] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, 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.

[Note 4] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, 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.

Attachment 2

October 31, 2008

Bank of Japan

At the Monetary Policy Meeting held today, the Bank of Japan decided, by the chairman's final decision after a split vote,[Note] to set the following guideline for money market operations for the intermeeting period (effective immediately):

> The Bank of Japan will encourage the uncollateralized overnight call rate to be at around 0.3 percent.

[Note] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, and Mr. T. Noda.
Voting against the action: Ms. M. Suda, Mr. A. Mizuno, Mr. S. Nakamura, and Mr. H. Kamezaki.

Attachment 3

October 31, 2008

Bank of Japan

Introduction of Complementary Deposit Facility
as a Temporary Measure to Facilitate Supplying of Funds

1. The Bank of Japan, based on the announcement released on October 8, has been reviewing the Bank's reserve system as a step to further improve the workings of money market operations in order to ensure stability in financial markets. As a conclusion has been drawn, the Policy Board of the Bank decided, at the Monetary Policy Meeting held today, to introduce Complementary Deposit Facility.[Note]

2. Global financial markets continue to remain under increased strains and their influences are beginning to be felt in Japanese financial markets. Under these circumstances, the Bank intends to provide sufficient liquidity toward the year-end and the fiscal year-end to ensure stability in financial markets. Provisioning of sufficient liquidity, however, may induce the uncollateralized overnight call rate (the policy interest rate) to sharply fall below its targeted level.

3. Complementary Deposit Facility is a temporary measure under which the Bank pays interest, calculated by the interest rate set below the targeted level of the policy interest rate, on excess reserve balances (balances held at the account with the Bank in excess of required reserves under the reserve deposit requirement system). This facility is expected to further increase the flexibility of the Bank's money market operations by enabling sufficient provision of liquidity while maintaining the policy interest rate at around its targeted level.

[Note] For details, see "Establishment of Principal Terms and Conditions of Complementary Deposit Facility as a Temporary Measure to Facilitate Supplying of Funds."

4. In view of maintaining the smooth functioning of money markets, the Bank has set the interest rate applied to excess reserve balances as 0.1 percent, 20 basis points below the Bank's target rate (0.3 percent). This measure will be effective from the November reserve maintenance period to the March 2009 reserve maintenance period.

5. The Bank will continue to do its utmost to ensure the stability of financial markets through money market operations complemented by the use of this facility.