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January 27, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on December 20 and 21, 2011

(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, December 20, 2011, from 2:00 p.m. to 4:32 p.m., and on Wednesday, December 21, from 9:00 a.m. to 12:11 p.m.[1]

Policy Board Members Present

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

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

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

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance[2]

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

Mr. K. Ishida, Senior Vice Minister, Cabinet Office[2]

Mr. H. Inoue, Deputy Director-General, Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. K. Yamamoto, Executive Director

Mr. H. Nakaso, Executive Director (Assistant Governor)

Mr. M. Amamiya, Executive Director

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on January 23 and 24, 2012 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. Y. Fujita and K. Ishida were present on December 21.

[3] Messrs. S. Sato and H. Inoue were present on December 20.

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Director-General, Monetary Affairs Department

Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department[4]

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

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

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

Mr. T. Sekine, Head of Economic Research Division, Research and Statistics Department

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

Secretariat of the Monetary Policy Meeting

Mr. Y. Iino, Director-General, Secretariat of the Policy Board

Mr. T. Tachibana, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. H. Chida, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

Mr. A. Okuno, Senior Economist, Monetary Affairs Department

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

[4] Messrs. T. Umemori and H. Chida were present on December 21 from 9:00 a.m. to 9:23 a.m.

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meetings on November 15 and 16 and on November 30, 2011, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[6] In this situation, the uncollateralized overnight call rate had been in the range of 0.075 to around 0.085 percent.

As for the Bank's U.S. dollar funds-supplying operation against pooled collateral, there were bids for funds with a maturity of three months amounting to nearly 5 billion U.S. dollars on December 13, 2011 and for those with a maturity of two weeks totaling over 9 billion U.S. dollars on December 20. Although the amounts were small compared with those recently provided by the European Central Bank (ECB) or the peak amounts provided by the Bank following the Lehman shock, the bids were relatively larger than before the lowering of the interest rate on the operation.

B. Recent Developments in Financial Markets

In the money market, interest rates had been stable as the sense of an abundance of liquidity continued to be strong amid the Bank's provision of ample funds. General collateral (GC) repo rates had been at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with longer maturities, had been stable at around 0.1 percent. Rates on longer-term interbank instruments had been more or less unchanged.

The benchmark long-term interest rate rose to the range of 1.05-1.10 percent, partly due to sales of bond futures by foreign investors triggered by large undersubscription in a German government bond auction, but had recently declined to below the 1.0 percent level partly due to buying on dips. Japanese stock prices, in line with U.S. and European stock prices, continued to show large fluctuations reflecting concerns over the possible outcome of the sovereign debt problems in Europe. The Nikkei 225 Stock Average, after temporarily dropping to the lowest level since the start of 2011, picked up slightly and had

[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 to 0.1 percent.

recently been in the range of 8,000-8,500 yen. In the foreign exchange market, the yen continued to move within a narrow range of around 77-78 yen against the U.S. dollar.

C. Overseas Economic and Financial Developments

The pace of recovery of the world economy was slowing.

The U.S. economy continued to recover, but the pace of recovery remained only moderate. Private consumption was increasing, but in a situation where balance-sheet adjustments were weighing on it, the pace of recovery generally remained only moderate. Housing investment remained at a depressed level with housing prices exhibiting weakness. On the other hand, exports and business fixed investment rose moderately. In this situation, production stayed on an increasing trend. As for prices, while slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, the year-on-year rate of increase in the consumer price index (CPI) for all items decelerated to some extent due to a fall in energy prices. Meanwhile, the year-on-year rate of increase in the CPI for all items less food and energy, or the core CPI, accelerated to some extent recently because the shelter index continued to rise moderately.

Economic activity in the euro area was increasingly sluggish. Growth in exports was sluggish owing to the slowdown in the world economy, and the rate of increase in business fixed investment had slowed. Private consumption was more or less unchanged. Household and business sentiment remained in a state of deterioration due to the worsening of the sovereign debt problems in Europe. Under these circumstances, production was declining. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items remained at a relatively high level. The slack in supply and demand conditions and the slow growth in wages continued to exert downward pressure on prices, while there was inflationary pressure from the impact of the increase in the value-added tax rate in Italy and the rise in prices of goods, including processed food, due to the continuing pass-through of the earlier increases in international commodity prices. Meanwhile, the level of economic activity in the United Kingdom was more or less unchanged.

With regard to Asia, the Chinese economy continued to show high growth as a whole. The rate of increase in exports was slowing and that in production was decelerating to some extent; however, private consumption and fixed asset investment maintained high growth. The growth rate of the Indian economy had decelerated due to the cumulative effects of monetary tightening. The pace of economic growth in the NIEs and the ASEAN countries was slowing to some extent. Domestic demand -- private consumption in particular -- remained firm, but exports and production declined due to the slowdown in advanced economies, and also to the effects of the flooding in Thailand. In many of these Asian economies, core inflation rates were still at relatively high levels, mainly reflecting the higher wage inflation caused by tight labor market conditions. On the other hand, inflation rates for all items were declining at a moderate pace due mainly to a halt in the surge in prices of fresh food.

Global financial markets remained under heavy strain on the whole. In early December 2011, risk aversion among investors temporarily eased somewhat due to expectations for policy actions by the European authorities and to the coordinated action by six central banks -- namely, the Bank of Canada, the Bank of England, the ECB, the Federal Reserve, the Swiss National Bank, and the Bank of Japan. Thereafter, however, investors turned cautious again as the view became increasingly prevalent that the European authorities' actions were insufficient as an immediate remedy. In this situation, U.S. and European stock prices had recently been on a declining trend, albeit with fluctuations, and the yield spreads of government bonds issued by European countries over German government bonds, having widened and then tightened, were recently widening again -- particularly in terms of those issued by Italy. With regard to the credit market, yield spreads between corporate bonds and government bonds were more or less unchanged in the United States, albeit at a relatively high level, while in Europe they were on a widening trend. As for the funding conditions of European financial institutions, spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates, as well as basis swaps, remained at elevated levels, albeit with fluctuations, reflecting concerns over counterparty risks. In financial markets in emerging economies, stock prices and currencies followed developments in the U.S. and European financial markets, and had declined recently.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports and production remained more or less flat, due in part to the effects of the slowdown in overseas economies and the yen's appreciation, as well as the flooding in Thailand. They were expected to stay this course for the time being and increase moderately thereafter, mainly reflecting a pick-up in the pace of recovery in overseas economies.

Public investment had stopped declining. It was expected to increase gradually, mainly due to the restoration of damaged social capital.

Business fixed investment had been on a moderate increasing trend, aided partly by the restoration of disaster-stricken facilities. It was expected to continue a moderate increasing trend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities as well as to strengthen earthquake resistance and business continuity systems, although it would be affected by the slowdown in overseas economies for the time being.

The employment and income situation continued to be severe, although there were signs of improvement.

Private consumption remained firm, and this situation was expected to continue as the employment situation gradually headed toward improvement.

Housing investment had generally been picking up. It was expected to increase gradually, albeit with fluctuations, mainly due to the reconstruction of disaster-stricken homes.

As for prices, international commodity prices had been more or less flat recently, after having trended downward from the peak around spring 2011. The three-month rate of change in the domestic corporate goods price index (CGPI) showed that it had been somewhat weak, mainly due to the earlier decline in international commodity prices, and it was expected to remain so for the time being. The year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and was expected to stay at this level for the time being.

2. Financial environment

Financial conditions continued to ease.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. Stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices. 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. As for credit demand, firms showed signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of change in bank lending had been slightly positive. The amounts outstanding of both corporate bonds and CP exceeded their previous year's levels. In these circumstances, firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock had been at around 3 percent.

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

On December 7, 2011, the Bank carried out a new loan disbursement, amounting to 162.9 billion yen, under the general rules for the fund-provisioning measure to support strengthening the foundations for economic growth. The outstanding balance of loans disbursed by the Bank under the general rules reached the ceiling of 3 trillion yen. Since the outstanding balance had reached the ceiling once before as a result of the previous loan disbursement in September 2011, the Bank carried out the new loan disbursement within the amount that became available mainly through repayments made before maturity. Meanwhile, under the special rules for equity investments and asset-based lending (ABL) to enhance this fund-provisioning measure, the Bank's new loan disbursement was 17.5 billion yen. The outstanding balance of loans under the special rules was 52.75 billion yen, and thus remained far below the ceiling of 500 billion yen. Nevertheless, further evidence of financial institutions' initiatives to utilize ABL -- loans without real estate collateral or guarantees -- had appeared, for example, in the form of five additional institutions among the number of borrowers of loans disbursed by the Bank.

II. Formulation of Essential Points regarding Temporary Bilateral Liquidity Swap Arrangements with Five Central Banks

A. Staff Proposal

At the unscheduled Monetary Policy Meeting held on November 30, 2011, the Bank decided to establish, as a contingency measure that would be in effect until February 1, 2013, bilateral liquidity swap arrangements with five other central banks -- namely, the Bank of Canada, the Bank of England, the ECB, the Federal Reserve, and the Swiss National Bank -- so that these six central banks could provide liquidity in each jurisdiction in any of their currencies should market conditions so warrant.

Since then, the staff had been deliberating on the specifics of the swap arrangements with these central banks. The staff had also deliberated on the framework for the Bank's provision of funds in foreign currencies -- other than the U.S. dollar -- that it obtained through the swap arrangements. Upon the completion of the deliberations, the staff made the following proposals.

(1) In order for the Bank to provide liquidity, should it be needed, in the four currencies other than the U.S. dollar -- namely, the Canadian dollar, the pound sterling, the euro, and the Swiss franc -- it should formulate the following: summaries of swap agreements with the four central banks other than the Federal Reserve, under which the Bank could sell yen to purchase each of the four currencies; principal terms and conditions for funds-supplying operations against pooled collateral for the four currencies; and procedures for selection of eligible counterparties in the operations.

(2) In order to enable the Bank to provide yen to the five central banks if required, it should formulate summaries of swap agreements with them, under which they could sell their currencies to purchase yen.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the staff proposals. They concurred that the staff should make public the essential points regarding the swap agreements accordingly.

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

A. Economic Developments

Members shared the view that concerns about the sovereign debt problems in Europe remained high in global financial markets. Some members noted that government bond yields in European countries had decreased, reflecting a positive response to progress on the fiscal compact made by the European Council, which was aimed at strengthening medium- to long-term fiscal discipline. They continued, however, that investors thus far did not appear to have significantly changed their cautious stance, for fear of the possibility suggested by major credit rating agencies of a downgrade to sovereign credit ratings for European countries. A few members noted that attention should be paid to the point that some market participants had renewed concern about the size of the outstanding amount of government debt in Japan. As for the funding conditions of European financial institutions, members concurred that concerns over funding had receded somewhat due to the coordinated action by the six central banks and introduction of longer-term refinancing operations with a maturity of 36 months by the ECB. Some members commented that the establishment of the network of bilateral liquidity swap arrangements -- the creation of a new framework through the coordinated action by the six central banks -- also had contributed to the alleviation of such concerns. However, many members said that global financial markets nevertheless remained under heavy strain, as seen in the fact that, while euro Libor declined mainly in response to the recent reduction in the policy interest rates by the ECB, U.S. dollar Libor continued to be on a moderate increasing trend and the cost of swapping euros into U.S. dollars remained at an elevated level. As for the outlook, members shared the view that financial markets were likely to remain under strain for a protracted period since there was no immediate remedy to the sovereign debt problems in Europe. Many members noted that the amount of refinancing of government bonds issued by countries with fiscal concerns, and of corporate bonds issued by European financial institutions, was expected to become large after the turn of the year. A few members said that, while European financial institutions were required to attain a capital ratio of 9 percent by the end of June 2012, they were already reducing their assets, particularly U.S. dollar-denominated ones. These members expressed concern that such moves could intensify in the future. In relation to this, a few other members commented that, since

European financial institutions were currently reducing their assets only at a moderate pace, other financial institutions were able to partly offset the reduction in some way. Some members said that, given that the presence of European financial institutions in emerging economies was not small, the effects on emerging economies of a possible acceleration in the reduction of their assets were highly uncertain and therefore should be monitored carefully.

Regarding the economic and financial conditions abroad, members concurred that the pace of growth in overseas economies had slowed mainly due to disturbances in global financial markets, on the back of the sovereign debt problems in Europe, and a subsequent decline in market confidence, as well as the cumulative effects of monetary tightening in emerging economies. As for the outlook, they shared the view that the pace of growth in overseas economies was likely to continue to slow for the time being, particularly in Europe and the United States, but would probably increase gradually thereafter led by emerging economies. One member pointed out that inflation rates were at relatively high levels, and this might make future policy conduct more difficult in both emerging and commodity-exporting economies as well as Europe and the United States; therefore, developments in inflation rates warranted careful attention.

Most members expressed the view that economic activity in the euro area on the whole was increasingly sluggish, as signs of sluggishness were becoming apparent not only in peripheral countries but also in major countries such as Germany. One member noted that recently released economic indicators showed that the German economy remained firm relative to other European economies. Many members pointed to the following as the background to the fact that economic activity was becoming sluggish even in major countries: (1) the spending behavior of households and firms had become cautious due to a deterioration in confidence; (2) stricter fiscal austerity had been exerting downward pressure on economic activity; and (3) downward pressure from the financial side had increased, reflecting more cautious lending attitudes at European financial institutions. Some members pointed out that the effects of the sovereign debt problems in Europe were not limited to Europe itself, but were spreading globally through international trade and financial markets. As for the outlook, members shared the view that economic activity in the euro area would continue to be quite sluggish for the time being against the background of continuing fiscal austerity and a deterioration in financial conditions. They agreed that the pace of economic recovery would subsequently remain only moderate as the adverse feedback loop continued to operate among the fiscal situation, the financial system, and economic activity. Members shared the view that, depending on developments in the sovereign debt problems in Europe, economic activity in Europe could turn out to be significantly weaker than expected, via instability in the financial system in particular. They continued that it was therefore necessary to continue to pay due attention to future developments because a further economic downturn in Europe could trigger a global economic downturn.

Members concurred that the U.S. economy continued to recover, but the pace of recovery remained only moderate. Some members said that firmness in private consumption -- as seen in the relatively good start to Christmas sales -- was worth noting, although it did not change the overall picture of the economy. One member commented that these developments reflected improvement in the employment and income situation led by the favorable conditions in the corporate sector. In response, a few members said that pessimistic views within the market seemed to have subsided somewhat, but there was a need to carefully examine economic indicators to see whether views regarding the U.S. economy would be revised again, given that shifts between pessimism and optimism had repeatedly occurred over short periods since the Lehman shock. A few members commented that the recent decline in the unemployment rate was primarily attributable to the drop in the labor force participation rate, and that the ratio of long-term unemployed workers to the total number of unemployed workers and the average duration of unemployment continued to be the worst on record. As for the outlook, members shared the view that, even if the U.S. economy continued to recover, the pace would be only modest given that the foundation for a recovery remained fragile -- as evidenced by the persistent strains from balance-sheet adjustments -- and that room for implementing policy actions was becoming limited. Some members commented that uncertainty was high even in terms of the outlook for private consumption, which appeared to have been firm recently, as there was limited room for a further decline in the personal saving rate and it was uncertain whether payroll tax cuts would be extended. Some members said that, given the close relations between the United States and Europe on the financial side, it should be borne in mind that the effects of the worsening of the sovereign debt problems in Europe would likely spread to the U.S. financial system.

Members agreed that the pace of growth in emerging and commodity-exporting economies had moderated somewhat, mainly due to the impact of a decrease in exports induced by a slowdown in European economies, as well as the effects of a decline in real purchasing power -- incurred by the earlier rise in prices -- and of monetary tightening. A few members noted that the effects of the sovereign debt problems in Europe were observed in some emerging and commodity-exporting economies not only through international trade but also through European financial institutions' reduction of their assets. As for China, one member commented that the member was closely monitoring developments in the housing market, which had recently been exhibiting signs of a slowdown, and the subsequent effects on the economy. Regarding price developments, some members said that -- in such economies as China where inflation rates were starting to decline, mainly reflecting the effects of monetary tightening -- private consumption would be supported by a recovery in real purchasing power and room for monetary easing seemed to be expanding. However, they highlighted that not a few economies still faced difficulty in the conduct of monetary policy because inflation was not contained. In this regard, a few members added that the situation differed by economy and it was therefore difficult to make an overall assessment of developments in emerging and commodity-exporting economies. One member raised three points as a focus of attention in considering the outlook for these economies: the degree of growth potential, the room for monetary easing, and the effects of the sovereign debt problems in Europe. Based on this discussion, members shared the view that a sharp economic deceleration was likely to be avoided in emerging and commodity-exporting economies since room for implementing policy actions was not limited on the monetary and fiscal sides, but that there remained a high degree of uncertainty about whether price stability and economic growth could be realized at the same time in these economies.

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

Regarding <u>recent developments in the economy</u>, members agreed that the pick-up in Japan's economic activity had paused, mainly due to the effects of the slowdown in overseas economies and the appreciation of the yen. They shared the view that business fixed investment had been on a moderate increasing trend, aided partly by the restoration of disaster-stricken facilities, and that private consumption remained firm, particularly in services consumption. They also shared the recognition that housing investment had generally been picking up and public investment had stopped declining. They concurred that exports and production remained more or less flat, due in part to the effects of the slowdown in overseas economies and the yen's appreciation, as well as the flooding in Thailand. A few members said that the effects of the sovereign debt problems in Europe were already starting to spread to Japan's exports and production, both directly and indirectly through international trade. Many members commented that, although the business sentiment at large manufacturing firms had become cautious, mainly due to the effects of the slowdown in overseas economies, the business sentiment of domestic demand-oriented sectors continued to improve and was firm. As background to such firmness, one member pointed to the possibility that, in addition to the contribution from the materialization of reconstruction-related demand after the earthquake disaster, improvement in the terms of trade due to the yen's appreciation was reflected more significantly in the profits of domestic demand-oriented firms than in the past.

As for the outlook for the economy, members shared the view that Japan's economic activity would remain more or less flat for the time being, but thereafter the economy was likely to return to a moderate recovery path as the pace of recovery in overseas economies picked up, led by emerging and commodity-exporting economies, and as reconstruction-related demand gradually materialized. Some members expressed the view that, compared with the forecast in the October 2011 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), the pace of the slowdown in overseas economies appeared to be somewhat more advanced and the materialization of reconstruction-related demand to be slightly delayed. A few members said that, while developments in the corporate sector were somewhat weak, those in the household sector were somewhat strong, and thus economic developments as a whole were generally in line with the forecast in the October 2011 Outlook Report. With regard to the recent weakness in machinery orders, a leading indicator of business fixed investment, a few members noted that it was necessary to carefully examine whether such developments were temporary. One of these members commented that the recent weakness in stock prices reflected cautious views on the outlook for corporate profits, and that in this situation it was possible that business fixed investment would be depressed. Following this discussion, members expressed the view that the Bank's baseline scenario -- that Japan's economy would return to a moderate recovery path as the pace of recovery in overseas economies picked up -- was generally maintained, and shared the view that they would reexamine this point in the interim assessment of the October 2011 Outlook Report, scheduled for January 2012. Some members commented that, in the January 2012 interim assessment, a smaller carry-over effect from fiscal 2010 on GDP growth for fiscal 2011 brought about by the rebasing of the GDP statistics from the 2000 base-year series to the 2005 base-year series would be a downward factor in the revision of the real GDP growth forecasts for fiscal 2011, although the rebasing did not affect actual economic conditions.

With regard to risks to the outlook for Japan's economy, members concurred that careful attention should continue to be paid to how the economy would be affected by uncertainty regarding financial and economic developments overseas. They shared the view that the sovereign debt problems in Europe in particular could result in weaker growth not only in the European economy but also in the global economy, especially through their effects on global financial markets. In addition, members agreed that the following could further increase strains in global financial markets: a large amount of refinancing of government bonds issued by countries with fiscal concerns, and of corporate bonds issued by European financial institutions, scheduled in early 2012, as well as the possibility of a downgrading of European government bonds. Some members said that, coupled with the effects of the appreciation of the yen, if overseas economies were to weaken further, it was more likely that Japan's exports would start declining as a trend and domestic demand -- such as business fixed investment -- would weaken, mainly reflecting a fall in stock prices and a deterioration in sentiment. As risk factors unique to Japan's economy, some members pointed to the uncertainty over electricity supply and a delay in the implementation of the reconstruction-related budget.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and likely to stay at this level for the time being. A few members said that supply and demand conditions in Japan continued to improve, in view of the developments in the diffusion indices for production capacity and for employment conditions in the December 2011 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), and that downward pressure on prices seemed to be easing. Members shared the view that considerable uncertainty surrounded the outlook for international commodity prices, with potential for movement in either direction. A few members added that it was necessary to pay attention to a deterioration in the situation surrounding Iran as an upward factor and the worsening of the sovereign debt problems in Europe as a downward factor.

B. Financial Developments

Members agreed that financial conditions in Japan continued to ease despite the continued heavy strains in global financial markets.

Members shared the view that, amid the Bank's provision of ample funds, money market rates continued to be stable, as evidenced by the fact that the overnight call rate remained at an extremely low level. One member commented that, as seen in the frequent undersubscription in multiple-rate competitive auctions by the Bank, the sense of an abundance of liquidity in the money market had grown further. Regarding liquidity conditions in U.S. dollar funding markets, some members expressed the view that, despite heightened concerns about counterparty risks in relation to European financial institutions, the funding conditions for Japanese banks remained stable on the whole. As for corporate financing, members agreed that firms' funding costs had declined moderately, and that firms continued to see financial institutions' lending attitudes as being on an improving trend. They shared the view that issuing conditions for CP remained favorable. Some members pointed out that credit spreads on corporate bonds had widened somewhat for those with low ratings and those that had been downgraded on concerns about a deterioration in the business performance of their issuers. Members, including these members, nevertheless shared the view that issuing conditions for corporate bonds remained favorable on the whole, and that firms retained their recovered financial positions.

Meanwhile, some members referred to the continued sluggishness in Japanese stock prices -- as seen in, for example, the Tokyo Stock Price Index (TOPIX) temporarily falling to around the lowest level since the Lehman shock -- reflecting the further worsening of the sovereign debt problems in Europe. They expressed concern that such developments in stock prices could depress business sentiment and thereby adversely affect economic activity.

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

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

With regard to monetary policy for the immediate future, some members expressed the view that the repeated expansions made to the total size of the Asset Purchase Program (hereafter the Program) had been effective to a certain extent, as seen in the fact that financial conditions in Japan continued to ease despite the persisting heavy strains in global financial markets. A few members said that the undersubscription that had frequently occurred in the Bank's outright purchases of corporate bonds under the Program was an indication that the effects of monetary easing had been spreading. They added that the Bank's continued purchases of corporate bonds would likely contribute to sustaining their favorable issuing conditions by reassuring investors. As for the outlook, a few members commented that it was necessary for the Bank to continue to make its utmost efforts to maintain financial market stability, bearing in mind the possibility of further disturbances in financial markets due to the worsening of the sovereign debt problems in Europe. A few other members noted that, from the perspective of maintaining financial market stability, it was also important for the Bank to clearly present the measures that had already been introduced, such as the coordinated action by the six central banks.

Based on this discussion, members shared the view that it was appropriate to steadily implement the Bank's decisions in August and October 2011 to increase the total size of the Program through the purchase of financial assets, and to monitor the spread of its effects. They concurred that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, it was necessary for the Bank to continue to consistently make contributions as the central bank by pursuing powerful monetary easing through the comprehensive monetary easing measures, ensuring financial market stability, and providing support to strengthen the foundations for economic growth.

With regard to the Bank's U.S. dollar funds-supplying operation against pooled collateral, members agreed that it had become more accessible for use as a result of the lowering of the interest rate on the operation, and that the operation's ability to stabilize the U.S. dollar funding rates and its role as a backstop had been strengthened. On the point that the cost of swapping yen into U.S. dollars remained elevated even after the lowering of the interest rate on the operation, some members noted that this did not suggest that Japanese banks were facing some difficulty in terms of funding; rather, it primarily reflected a decline in liquidity in foreign exchange swap markets in view of the approach of the year-end. A few members commented that it was of critical importance that the Bank continue to conduct the operation because events in Europe that were anticipated from the start of 2012 could destabilize U.S. dollar funding markets.

With regard to the Bank's lending under the special rules for equity investments and ABL to enhance the fund-provisioning measure to support strengthening the foundations for economic growth, members agreed that this was playing the role of a catalyst in promoting financial institutions' efforts to utilize ABL. Regarding the fact that the Bank's new loan disbursement under the special rules was only 17.5 billion yen, one member commented that the amount was within the range that was anticipated considering the market size of ABL and the time required for establishing a framework for such lending at financial institutions. This member continued, however, that it was nevertheless necessary for the Bank to continue to encourage financial institutions' efforts to utilize ABL.

V. Remarks by Government Representatives

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

(1) The Japanese economy had been picking up, but the pace was decelerating. The government was highly concerned that the appreciation of the yen and increased evidence of sluggishness in overseas economies, due to the anxiety over debt problems in Europe, continued to pose significant downside risks to the Japanese economy.

(2) In November 2011, the Diet approved the third supplementary budget for fiscal 2011, a substantial one for rebuilding. The government appropriated funds in the budget for measures that would contribute to addressing excessive appreciation of the yen, and aimed to achieve revitalization of the Japanese economy and society through prompt implementation of the budget. On December 20, the fourth supplementary budget was decided by the Cabinet. This budget was formulated to meet the additional fiscal demand without issuing additional government securities.

(3) On December 10, the Cabinet decided an outline for tax reform in fiscal 2012, which primarily focused on taxation measures that would contribute to economic growth strategies and measures for ensuring the equity of taxation and promoting its fairness. The government would submit to the Diet the necessary bills, in accordance with the outline.

(4) Considering that the downside risks to the economy were extremely high due to the appreciation of the yen and concerns over stagnant overseas economies, the government deemed it important to continue to give careful consideration to the future conduct of macroeconomic management while making appropriate responses, and acknowledged that it would work closely with the Bank. Furthermore, the government hoped that the Bank would continue to share its view on the current severe economic conditions and take decisive monetary policy actions while considering the effects on the Japanese economy of the developments in overseas economies and disturbances in the financial markets, including the foreign exchange market.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy continued to pick up, but the pace was decelerating. As for the outlook, risk factors such as the appreciation of the yen and the slowdown in overseas economies required strong vigilance. In particular, with regard to the sovereign debt crisis in Europe, financial markets remained unstable despite efforts made by, for example, the European Council. Some overseas central banks had implemented monetary easing in anticipation of a slowdown in the global economy. In these circumstances, it was important for the government and the Bank to continue to keep close contact, addressing common concerns and sharing a sense of urgency.

(2) The government would make its utmost efforts to achieve rebuilding following the disaster. It would also swiftly and steadily implement the "Comprehensive Package Responding to the Yen Appreciation" and the third supplementary budget in order to respond to the downside risks to the economy, stemming mainly from the appreciation of the yen. The Cabinet decided the fourth supplementary budget, in which 300 billion yen was appropriated for subsidies for purchasers of environmentally friendly cars. The government would promptly formulate the budget for fiscal 2012, which

focused on rebuilding following the disaster and revitalization of the Japanese economy, and would work to submit the two budgets to the Diet and obtain its approval swiftly.

(3) Furthermore, the government had been making its utmost efforts to carry out the comprehensive reform of social security and taxation systems with the aim of making steady progress toward medium-term fiscal consolidation. The Japanese economy continued to be in a mild deflationary phase, and overcoming deflation was a challenge that had remained unsolved for over ten years. Now that reconstruction-related demand was expected to emerge, it was time for the government and the Bank to work even more closely to make sustained efforts to overcome deflation. The government expected the Bank to conduct monetary policy appropriately and decisively with a view to overcoming deflation, in addition to preventing an economic slowdown.

VI. Votes

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

To reflect this view, the chairman formulated the following proposal and put it to a vote.

The Chairman's Policy Proposal on the Guideline for Money Market Operations:

1. The guideline for money market operations for the intermeeting period ahead will be as follows.

> The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

2. A public statement will be decided separately.

> Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.
>
> Votes against the proposal: None.

VII. Discussion on the Statement on Monetary Policy

Members discussed the Statement on Monetary Policy, and it was put to a vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment 1).

VIII. Approval of the Minutes of the Monetary Policy Meetings

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of November 15 and 16, and November 30 for release on December 27, 2011.

IX. Approval of the Scheduled Dates of the Monetary Policy Meetings in January-December 2012

At the end of the meeting, the Policy Board approved the dates of the Monetary Policy Meetings to be held in the period of January-December 2012 for immediate release (see Attachment 2).

Attachment 1

December 21, 2011

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,[7] to set the following guideline for money market operations for the intermeeting period:

   The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

2. The pick-up in Japan's economic activity has paused, mainly due to the effects of a slowdown in overseas economies and of the appreciation of the yen. As for domestic demand, business fixed investment has been on a moderate increasing trend and private consumption has remained firm. On the other hand, exports and production have remained more or less flat, due in part to the effects of the slowdown in overseas economies and of the yen's appreciation as well as of the flooding in Thailand. Improvement in business sentiment has slowed on the whole despite steady improvement in domestic demand-oriented sectors. Meanwhile, although global financial markets remain under heavy strain, financial conditions in Japan have continued to ease. The year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent.

3. As for the outlook, Japan's economic activity will remain more or less flat for the time being. After that, the economy is expected to return to a moderate recovery path as

[7] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida. Voting against the action: None.

the pace of recovery in overseas economies picks up, led by emerging and commodity-exporting economies, and reconstruction-related demand after the earthquake disaster gradually materializes. The year-on-year rate of change in the CPI is expected to remain at around 0 percent for the time being.

4. Regarding risks to the economic outlook, the sovereign debt problem in Europe could result in weaker growth not only in the European economy but also in the global economy particularly through its effects on global financial markets. In the U.S. economy, there is a possibility that the slowdown will be prolonged mainly due to the effects of balance-sheet repair. As for emerging and commodity-exporting economies, there remains a high degree of uncertainty about whether price stability and economic growth can be realized at the same time. Careful attention should continue to be paid to how Japan's economy will be affected by the above uncertainty regarding financial and economic developments overseas. Regarding risks to the price outlook, considerable uncertainties surround future developments in international commodity prices, leaving potential for movement in either direction. There is also a possibility that the rate of inflation will deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations.

5. The Bank has repeatedly expanded the size of the Asset Purchase Program on a significant scale, and is steadily implementing the Program mainly through the purchase of financial assets. The Bank has also made it clear that it is committed to continuing the virtually zero interest rate policy until it judges that price stability is in sight on the basis of the "understanding of medium- to long-term price stability."[8] In order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank will continue to consistently make contributions as the central bank by pursuing powerful monetary easing through the comprehensive monetary easing measures as described above, ensuring financial market stability, and providing support to strengthen the foundations for economic growth.

[8] The current understanding on the basis of a year-on-year rate of change in the CPI is "a positive range of 2 percent or lower, centering around 1 percent."

Attachment 2

December 21, 2011

Bank of Japan

Scheduled Dates of Monetary Policy Meetings in January 2012-December 2012

	Date of MPM	Publication of MPM Minutes	Publication of Outlook Report (The Bank's View)	(Reference) Publication of Monthly Report
Jan. 2012	23 (Mon.), 24 (Tues.)	Feb. 17 (Fri.)	--	25 (Wed.)
Feb.	13 (Mon.), 14 (Tues.)	Mar. 16 (Fri.)	--	15 (Wed.)
Mar.	12 (Mon.), 13 (Tues.)	Apr. 13 (Fri.)	--	14 (Wed.)
Apr.	9 (Mon.), 10 (Tues.)	May 7 (Mon.)	--	11 (Wed.)
	27 (Fri.)	May 28 (Mon.)	27 (Fri.)	--
May	22 (Tues.), 23 (Wed.)	June 20 (Wed.)	--	24 (Thurs.)
June	14 (Thurs.), 15 (Fri.)	July 18 (Wed.)	--	18 (Mon.)
July	11 (Wed.), 12 (Thurs.)	Aug. 14 (Tues.)	--	13 (Fri.)
Aug.	8 (Wed.), 9 (Thurs.)	Sep. 24 (Mon.)	--	10 (Fri.)
Sep.	18 (Tues.), 19 (Wed.)	Oct. 11 (Thurs.)	--	20 (Thurs.)
Oct.	4 (Thurs.), 5 (Fri.)	Nov. 2 (Fri.)	--	9 (Tues.)
	30 (Tues.)	Nov. 26 (Mon.)	30 (Tues.)	--
Nov.	19 (Mon.), 20 (Tues.)	Dec. 26 (Wed.)	--	21 (Wed.)
Dec.	19 (Wed.), 20 (Thurs.)	To be announced	--	21 (Fri.)

Note: The time of release will be, in principle, as follows.

MPM Minutes will be released at 8:50 a.m.

Outlook for Economic Activity and Prices (Outlook Report):
"The Bank's View" in the Outlook Report will be released at 3:00 p.m., and the full text at 2:00 p.m. on the next business day. As an exception to this principle, the full text of the April 2012 Outlook Report will be released at 2:00 p.m. on April 28 (Sat.), 2012.

Monthly Report of Recent Economic and Financial Developments (Monthly Report):

The Japanese original and the English translation for summary will be released at 2:00 p.m. (the English translation for the full text will be published at 4:30 p.m. on the next business day).