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November 6, 2013

Bank of Japan

Minutes of the Monetary Policy Meeting

on October 3 and 4, 2013

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Thursday, October 3, 2013, from 2:00 p.m. to 4:36 p.m., and on Friday, October 4, from 9:00 a.m. to 11:44 a.m.[1]

Policy Board Members Present

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

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

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

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Mr. T. Sato

Mr. T. Kiuchi

Government Representatives Present

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

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

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

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

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

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

[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on October 31, 2013 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Mr. Y. Furukawa was present on October 4.

[3] Mr. M. Asakawa was present on October 3.

Mr. M. Nomura, Deputy Director-General, Monetary Affairs Department[4]

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

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

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

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

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

Secretariat of the Monetary Policy Meeting

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

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

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

Mr. Y. Komaki, Senior Economist, Monetary Affairs Department

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

Mr. K. Suzuki, Head of Market Operations Division, Financial Markets Department[4]

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[4] Messrs. M. Nomura, H. Kamiguchi, and K. Suzuki were present on October 4 from 9:00 a.m. to 9:25 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 meeting on September 4 and 5, 2013, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[6] In this situation, the amount outstanding of the monetary base had been in the range of 175-190 trillion yen.

B. Recent Developments in Financial Markets

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

Long-term interest rates in Japan had fallen due to the decline in U.S. long-term interest rates and to the Bank's JGB purchases. The Nikkei 225 Stock Average had moved upward, mainly due to the announcement that Tokyo had been chosen to host the 2020 Olympic Games, but declined thereafter, primarily reflecting the yen's appreciation and the decline in U.S. stock prices. Prices for Japan real estate investment trusts (J-REITs) had risen significantly, mainly reflecting an increase in prices for overseas REITs. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, despite a widening in some corporate bond spreads. In the foreign exchange market, although the yen had temporarily depreciated slightly against the U.S. dollar, mainly reflecting the rise in Japanese stock prices, it had appreciated thereafter, primarily due to speculation about the direction of U.S. monetary policy and uncertainty regarding the fiscal debate in the United States.

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

C. Overseas Economic and Financial Developments

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

The U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, despite downward pressure from the fiscal side. Federal government expenditures had still been declining. On the other hand, private consumption remained on a moderate increasing trend as the employment situation followed an improving trend and asset prices rose. Housing investment continued to generally pick up. Exports were also increasing moderately. Reflecting these developments in demand, business sentiment continued to follow an improving trend, and production as well as business fixed investment were heading toward a pick-up, although the pace remained slow. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less food and energy, or the core CPI, had been more or less flat. In this situation, the year-on-year rate of increase in the CPI for all items had declined, mainly as a result of the drop in energy prices.

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

With regard to Asia, the Chinese economy continued to see stable growth on the back of firm domestic demand. Exports had shown signs of a pick-up but remained relatively weak. On the other hand, stable growth in private consumption continued on the back of a favorable employment and income situation, although effects of the government's frugality campaign continued to be observed in some areas. Fixed asset investment had been firm amid the continued high growth in infrastructure investment. With these developments in demand, growth in production had risen somewhat, particularly that in materials industries. As for prices, the year-on-year rate of increase in the CPI had been somewhat low. Regarding the NIEs and the ASEAN countries, developments toward a pick-up had been weakening on the whole, due to deceleration in domestic demand as well as sluggish trade. Private consumption had been decelerating, particularly in the ASEAN countries, against the background of (1) the end to the boost from policy measures targeted at car sales and (2) consumer sentiment having turned cautious. Exports continued to show some weakness on the whole, although signs of a pick-up had been observed in the NIEs. Reflecting these developments in demand, moves toward a pick-up in production remained paused, and growth in business fixed investment, particularly in machinery investment, had been sluggish. As for prices, the year-on-year rates of increase in the CPI generally continued to be at somewhat low levels, although there were differences by country and region. In India, the economy remained in a state of deceleration, particularly in domestic demand.

Global financial markets had become somewhat nervous on the back of, for example, speculation about the direction of U.S. monetary policy and difficulties surrounding the fiscal debate in the United States. In the European and U.S. markets, following the results of the Federal Open Market Committee (FOMC) meeting held on September 17 and 18, yields on government bonds had declined and stock prices had risen, with the latter due also to abating uncertainty regarding the situation in the Middle East. However, U.S. stock prices had recently turned toward a decline as a result of heightening uncertainty regarding the fiscal debate in the United States, such as over the debt ceiling problem. In emerging markets, on the other hand, the stock and bond price declines and the depreciation in foreign exchange rates -- which had happened simultaneously -- had paused, and the prices and exchange rates in some of these emerging countries had bounced back. Meanwhile, international commodity prices had recently been more or less flat on the whole, although they continued to be weak from a relatively longer-term perspective in a situation where recovery in emerging economies lacked momentum.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had generally been picking up. Real exports had turned upward in the January-March quarter of 2013 on a quarter-on-quarter basis for the first time in three quarters and had grown at an accelerated rate in the April-June quarter. They then declined only marginally in the July-August period compared with the April-June quarter. Monthly figures showed that the increase in August outpaced the significant decline in July. Exports were expected to increase moderately, mainly against the background of the pick-up in overseas economies.

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

Business fixed investment had been picking up as corporate profits had improved. Meanwhile, business sentiment continued to improve, and in the September 2013 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), the diffusion index for business conditions for all industries and enterprises (the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable") moved into positive territory for the first time in almost six years. The aggregate supply of capital goods -- a coincident indicator of machinery investment -- had dropped temporarily in the April-June quarter on a quarter-on-quarter basis, after having turned upward in the January-March quarter, but increased again in the July-August period relative to the April-June quarter. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- had turned upward in the April-June quarter for the first time in five quarters, after having been almost flat in the January-March quarter on a quarter-on-quarter basis, and continued to advance in July relative to the April-June quarter. Business fixed investment was projected to follow a moderate increasing trend as corporate profits continued to improve. Business fixed investment plans (excluding software investment and including land purchasing expenses) for fiscal 2013 in the September *Tankan* had been revised upward in comparison to the June *Tankan* for all industries and enterprises, and registered a year-on-year increase of 3.3 percent.

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

Private consumption remained resilient, with some improvement observed in the employment and income situation. On a quarterly basis, sales at department stores dropped in the July-August period relative to the April-June quarter of 2013, after having increased for three quarters in a row since the October-December quarter of 2012. On a monthly basis, however, they picked up in August after having fallen back in July, due in part to the front-loading of summer discount sales; as a trend, sales at department stores remained firm, notably in imports and high-end products. Sales at convenience stores continued to trend moderately upward. As for services consumption, outlays for travel and sales in the food service industry as a whole had held steady. Private consumption was expected to remain resilient, supported by improvement in the employment and income situation.

Housing investment had increased and was expected to continue trending upward.

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

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

2. Financial environment

Financial conditions were accommodative.

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

Firms' funding costs had been hovering at low levels. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. Firms' credit demand had been increasing moderately, mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending had been in the range of 2.0-2.5 percent. The year-on-year rate of change in the amount outstanding of CP and corporate bonds had been positive. Firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of growth in the money stock had been in the range of 3.5-4.0 percent, mainly due to the increase in bank lending.

3. The fund-provisioning measure to stimulate bank lending

On September 17, 2013, the Bank carried out a new loan disbursement, amounting to 881.2 billion yen, under the fund-provisioning measure to stimulate bank lending. The breakdown by type of borrower showed that 614.2 billion yen was disbursed to major banks and 267.0 billion yen to regional banks and other financial institutions. In terms of duration, most of the loans were disbursed with a maturity of three years. The outstanding balance of loans disbursed by the Bank amounted to 4,031.5 billion yen after the new loan disbursement, thus exceeding 4 trillion yen.

II. Amendment to Guidelines on Eligible Collateral

A. Staff Proposal

The staff proposed that the Bank make necessary amendments, including those to its Guidelines on Eligible Collateral and the principal terms and conditions for repo operations and securities lending, in order to (1) enable the Bank to accept electronically recorded monetary claims as eligible collateral for the Bank's provision of credit with a view to further facilitating the Bank's money market operations, and (2) reflect the results of the Bank's annual review of appropriate margins for eligible collateral in light of recent developments in financial markets.

B. Discussion by the Policy Board and Vote

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

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

A. Economic Developments

Members shared the recognition that global financial markets had become somewhat nervous on the back of, for example, speculation about the direction of U.S. monetary policy and difficulties surrounding the fiscal debate in the United States. In relation to U.S. monetary policy, many members pointed out that long-term interest rates had declined and stock prices had risen, following the results of the FOMC meeting held on September 17 and 18. Some members expressed the recognition that market participants seemed to perceive that it had become more difficult to predict the direction of monetary policy, and it was necessary to pay attention to the risk that large fluctuations would occur again in the markets, depending on developments in U.S. monetary policy. One member expressed the view that the rapid tightening of financial conditions, amid the slow pace of improvement in the employment situation and the continuing disinflationary trend, had affected the decision made at the FOMC meeting. With regard to the outcome of the fiscal debate in the United States, a different member noted that many market participants took the view that the fiscal debate would be resolved in a short period of time, but that this situation could not be viewed optimistically given the rise in yields on T-Bills maturing in October. As for emerging markets, a few members pointed out that these had regained stability for the immediate future, as evidenced by the fact that the stock and bond price declines and the depreciation in foreign exchange rates -- which had happened simultaneously -- had paused. However, these members continued that, if speculation about the direction of U.S. monetary policy heightened, outflows of funds from emerging economies and accompanying turmoil in the markets could occur again.

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

Members agreed that the U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, such as private consumption and housing investment, despite downward pressure from the fiscal side. As for the outlook, they shared the view that, while the outcome of the fiscal debate in the United States warranted attention, the pace of economic recovery would gradually rise on the whole, albeit moderately, because accommodative financial conditions would likely continue and downward pressure from the fiscal side would likely ease gradually. One member noted that private consumption would likely remain firm, as the effects of the expiration of the payroll tax cut had waned and disposable income had been increasing moderately amid the improvement in the employment situation. Regarding housing investment, a different member expressed the recognition that, although some recent indicators had been relatively weak, it would return to an improving trend as interest rate developments stabilized, given that households' purchasing behavior with respect to housing was strong and the level of housing inventories was low. Meanwhile, one member pointed out that attention needed to be paid to possible effects on economic activity in the event of speculation about the direction of U.S. monetary policy leading to another surge in interest rates while weakness remained in the housing and labor markets. With regard to the outcome of the fiscal debate in the United States, such as that of the debt ceiling problem, many members said that, if a high degree of uncertainty regarding fiscal policy persisted, the economy could be adversely affected through a deterioration in economic entities' sentiment and a destabilizing in financial markets; therefore, it was necessary to carefully monitor these developments. One of these members added that, if the fiscal debate were not resolved in a short period of time, this could cause turmoil in global financial markets through, for example, a decline in the credibility of U.S. Treasuries, and consequently might have significant adverse effects on the global economy. This member continued that, by contrast, early resolution of the debate would eliminate the current uncertainty, and thus might provide a boost toward economic recovery.

Members shared the recognition that economic activity in the euro area as a whole had bottomed out. As for the outlook, they concurred that the economy would gradually start picking up, triggered by an improvement in economic entities' sentiment and the pick-up in exports. On this basis, they shared the recognition that there remained a high degree of uncertainty concerning the prospects for the European debt problem.

Members agreed that the Chinese economy continued to see stable growth on the back of firm domestic demand. A few members pointed out that, supported in part by the measures taken by the government to underpin the economy, fixed asset investment continued to show relatively high growth and production was also increasing. As for the outlook, members shared the view that, although downward pressure would likely be exerted on domestic demand in the process of making structural adjustments, the economy as a whole would continue to see stable growth at around the current pace since external demand was likely to head toward a pick-up.

Regarding the NIEs and the ASEAN countries, members concurred that developments toward a pick-up had been weakening on the whole, due to deceleration in domestic demand as well as sluggish trade. One member, noting that Japan's exports to the ASEAN countries had been decreasing recently, expressed the view that this might be attributable to an outflow of funds from these economies arising from heightening speculation about the direction of U.S. monetary policy. A different member noted that the view could be maintained that these economies would head toward a pick-up on the whole, albeit with some differences in degree by country. As for the outlook, members shared the recognition that the pace of economic growth in the NIEs and the ASEAN countries would likely remain relatively slow for the time being, but thereafter would gradually rise as advanced economies picked up. One member expressed the view that the risk of economic deceleration in some emerging economies spreading throughout Asia seemed to have subsided, partly due to the fact that financial markets had calmed down and to policy actions. However, some members said that it was necessary to continue to pay attention to the possibility that, depending on financial developments in the United States, emerging markets would become unstable. A different member pointed out that the effects of the earlier tightening of financial conditions and the fall in stock prices would be apparent for the time being, and in some emerging economies -- where structural problems had materialized in the meantime -- downward pressure on economic activity might become stronger as adjustments in economic structures proceeded in a full-fledged manner. Meanwhile, one member expressed the recognition that, from a medium- to long-term perspective, depreciation of currencies had a positive aspect, in that it would lead to, for example, increases in exports, declines in current account deficits, and economic recovery.

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

With regard to economic activity, members concurred that the economy was recovering moderately as a virtuous cycle from income to spending seemed to be operating both in the corporate and household sectors.

Specifically, members shared the recognition that, as overseas economies as a whole were gradually heading toward a pick-up, Japan's exports had generally been picking up, underpinned partly by developments in foreign exchange rates. Some members expressed the view that the pick-up trend in exports was confirmed by the fact that the increase in real exports in August outpaced the decline in July. One member noted that the pace of increase in exports would rise as overseas economies picked up. In response, a different member pointed out that real exports had been more or less flat on average in the July-August period compared with the April-June quarter. This member then expressed the recognition that such developments partly reflected the decline in the competitiveness of manufacturing in Japan, which might become a factor that would restrain the pace of economic recovery. Members agreed that business fixed investment had been picking up as corporate profits had improved. A few members expressed the recognition that business fixed investment on a real GDP basis for the April-June quarter had been revised upward in the second preliminary estimate, thereby turning positive on a quarter-on-quarter basis for the first time in six quarters, and therefore the pick-up in such investment was confirmed. Some members pointed out that both the aggregate supply of capital goods and machinery orders were increasing as well. As for the results of the September 2013 *Tankan*, members shared the view that business sentiment clearly continued to improve, both in large and small firms in manufacturing and nonmanufacturing. Many members pointed out that business plans for fiscal 2013 indicated that firms were planning to steadily increase fixed investment as they revised upward their projections for sales and profits, and confirmed that improvement in corporate profits was leading to positive spending. On the other hand, a few members expressed the view that the year-on-year rate of change in business fixed investment plans of large manufacturing firms had been relatively low compared with the past. One of these members added that more time was required for a full-fledged recovery in business fixed investment, as firms were curtailing domestic business fixed investment until they became more confident in the yen's depreciating trend. Members shared the recognition that private consumption remained resilient, with some improvement observed in the employment and income situation. One member said that private consumption remained firm, albeit with monthly fluctuations, as evidenced by the fact that sales at large retail stores picked up again in August after having fallen back in July due to the front-loading of summer discount sales. In response, a different member took a somewhat cautious view that there might be a reversal of favorable developments -- observed during the January-March and April-June quarters -- in private consumption for the July-September quarter. As for the employment and income situation, some members expressed the view that, although the unemployment rate had increased somewhat in August, supply and demand conditions in the labor market continued to improve, taking into account improvements in the active job openings-to-applicants ratio and the diffusion index for employment conditions in the September *Tankan*. One of these members added that a clear increase was observed in the number of new job openings in manufacturing, which had been lagging behind. Members concurred that housing investment had increased. They shared the view that industrial production was increasing moderately, reflecting these developments in demand both at home and abroad.

As for the outlook for the economy, members shared the view that the economy was likely to continue its moderate recovery as the virtuous cycle among production, income, and spending continued to operate. A few members pointed out that, in order to achieve a sustainable economic recovery, it was important that the recovery spread from domestic demand to external demand, as well as from nonmanufacturing to manufacturing. However, these members noted that the pace of recovery in exports and production had lacked strength so far. One member expressed the recognition that, while economic activity in manufacturing might be weaker than expected due to factors such as a delay in overseas economic recovery, that in nonmanufacturing might be stronger than expected due to nonmanufacturers' progress in tapping demand, such as for services related to the aging population. Members shared the view that, in order for domestic demand to maintain its firmness, it was important that the virtuous cycle of improvement in the employment and income situation supporting consumption continue. On this basis, they agreed that a pick-up in employee income was likely to gradually become clearer. One member, expressing the view that increases in base salaries in particular were essential, pointed out that it was difficult for Japanese firms to find the incentive to raise base salaries to retain regular employees, due to the low mobility in the labor market in Japan. The member therefore expressed hope that various measures to encourage firms to raise wages would be effective. A different member -- while expressing hope for an increase in base salaries in spring 2014 -- recognized that it was difficult to expect a marked improvement in the income situation until then, with the exception of upward pressure from bonuses. With regard to the effects of the scheduled consumption tax hikes, one member expressed the view that downward risk on private consumption might be restrained to some extent on the following grounds: (1) consumers' outlook for permanent income was expected to improve on the back of an increase in labor productivity; (2) amid improvement in the employment situation, the borrowing constraints of households were likely to lessen, thereby making it easier for them to smooth their consumption; and (3) measures aimed at easing the negative effects of the tax hikes on low-income households would be implemented. In relation to this point, a different member pointed out that a key to a rise in wages would be how to increase the relatively low labor productivity of the services industry given its increasing weight in Japan's industrial structure. A few members commented that it had become less likely that economic activity in Japan would deteriorate due to the effects of the government's economic policy package.

With regard to risks to the outlook for Japan's economy, members concurred that there remained a high degree of uncertainty concerning the economy, including the prospects for the European debt problem, developments in the emerging and commodity-exporting economies, and more recently, an increasing need to pay attention to the outcome of the fiscal debate in the United States.

Regarding prices, members shared the view that the year-on-year rate of change in the CPI (all items less fresh food) was in the range of 0.5-1.0 percent, and was likely to rise gradually. Many members expressed the recognition that recent movements in the CPI were attributable to not only upward pressure from movements in energy-related goods but also price rises observed across a wide range of items. One member expressed the view that firms' price-setting behavior seemed to be starting to change against the backdrop of resilient private consumption, as seen in the diffusion index for output prices in the September 2013 *Tankan*, and that prices of a wide range of items including food products were likely to continue trending upward. One member said that the improvement in the diffusion index for output prices and the narrowing of the gap between the diffusion indexes for output and input prices in the September *Tankan* suggested that firms might come to find it easier to pass higher costs on to sales prices, and as a result, raise wages. In response to these remarks, a few members expressed the view that the aforementioned rise in the year-on-year rate of increase in the CPI might come to a pause as effects of the reversal of the previous year's decline in energy prices disappeared. One of these members was closely monitoring whether factors specific to Japan could lead to a rise in the rate of change in the CPI in a situation where signs of improvement in the global disinflationary trend could not yet be observed. As for inflation expectations, members shared the recognition that, considering the results of surveys conducted on households, economists, and market participants, these appeared to be rising on the whole. In considering the outlook for prices, a few members commented that they were paying attention to developments in medium- to long-term inflation expectations, which were rising at a moderate pace at present.

B. Financial Developments

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

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

Based on the above assessment of economic and financial developments, members discussed monetary policy for the immediate future.

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that it was appropriate to maintain the current guideline that the

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

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

With respect to the future conduct of monetary policy, most members shared the view that the Bank would continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it was necessary for maintaining this target in a stable manner. These members continued that, in doing so, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. In response, one member expressed concern that, in a situation where it seemed difficult to achieve the price stability target in about two years, if a rise were to occur in markets' anticipation that quantitative and qualitative monetary easing would continue for a protracted period or extreme additional measures would be implemented, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, this member said that it was appropriate to change the expression representing the Bank's commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner. The member added that, in order to achieve the price stability target of 2 percent, it was necessary that the recognition be shared among firms, households, and financial markets that the targeted level of 2 percent was consistent with economic fundamentals. Meanwhile, a few members pointed out that it was important for the Bank to continue devising ways to communicate more effectively to the markets while taking account of the recent experiences of the United States. With regard to the relationship between the government's decision to raise the consumption tax rate and the Bank's conduct of monetary policy, one member pointed out that the Policy Board members' forecasts of Japan's economic activity and prices had incorporated the scheduled consumption tax hikes, and that the decline in demand subsequent to the front-loaded increase had already been factored into the Bank's policy decisions.

With regard to the effects of quantitative and qualitative monetary easing, members shared the recognition that these continued to firmly take hold, and financial conditions were easing steadily to underpin firms' and households' spending. They agreed that, in this situation, there was a wider range of positive movements in economic activity and financial markets, and people's expectations for economic activity and prices had turned favorable. Regarding how much of an effect could be exerted on longer-term interest rates, many members noted that long-term interest rates in Japan had been stable at low levels under the Bank's massive JGB purchases. One member expressed the recognition that it was nevertheless necessary to continue to pay attention to the risk that some events might trigger large fluctuations in interest rates. In relation to developments in the JGB market, a different member welcomed the government's strong stance on fiscal consolidation, which was evidenced by its decision to raise the consumption tax rate. On the other hand, a different member noted that there was a view among some market participants that the government's stance in terms of its efforts to achieve fiscal consolidation had actually weakened in the course of discussion leading up to the decision on the tax increase. With regard to effects brought about through fundamental changes in economic entities' expectations, many members expressed the view that, in a situation where nominal interest rates had been stable, real interest rates were declining on the back of a rise in inflation expectations. One of these members pointed out that economic activity to date had been boosted by wealth effects stemming from the markets' incorporation of bold monetary easing at an early stage, and that from now on stimulative effects on economic activity -- triggered by the decline in real interest rates -- would take hold in a full-fledged manner. One member expressed the recognition that, although the rise in asset prices had been driven thus far mainly by overseas investors, portfolio rebalancing by domestic investors such as firms, individuals, and pension funds would proceed steadily.

As for the effects of the recent decline in yields on T-Bills, as well as the recent decrease in the bid-to-cover ratios of money market operations, many members expressed the recognition that these were attributable to a temporary factor -- that is, the increase in financial institutions' need to hold T-Bills with the approach of the end of the first half of the fiscal year. One member commented that the amount outstanding of the monetary base had been accumulating as scheduled. A different member expressed the recognition that, in order for quantitative and qualitative monetary easing to be effective, it was important that the Bank accumulate the amount outstanding of the monetary base in line with its target and thereby continue to exert influence on the expectations of economic entities. Based on this discussion, members confirmed that the Bank would aim for steady accumulation of the amount outstanding of the monetary base while closely monitoring future developments, including the situation after the end of the first half of the fiscal year.

Regarding <u>the fund-provisioning measure to stimulate bank lending</u>, one member expressed the view that, although the Bank's new loan disbursement in September had declined substantially from that in June, it was expected that financial institutions would increase their use of the measure given that (1) the period for the September disbursement covered the April-June quarter, when bank lending generally showed a seasonal decline, and (2) the amount outstanding of bank lending had been increasing steadily, with the year-on-year rate of increase in the range of 2.0-2.5 percent.

V. Remarks by Government Representatives

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

(1) With regard to the recent economic situation in Japan, the government deemed that the effects of the economic policy -- on which the government had been working closely with the Bank -- had begun to emerge steadily, as evidenced, for example, by the fact that the economy was on the way to recovery at a moderate pace and price developments as a whole indicated that deflation was ending. It expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing and achieve the price stability target of 2 percent at the earliest possible time.

(2) The government deemed that it was a critical challenge to maintain confidence in public finance and pass a sustainable social security system on to future generations. From this viewpoint, it confirmed that the consumption tax rates would be raised from 5

percent to 8 percent on April 1, 2014, taking into account that the Japanese economy had started to show signs of recovery.

(3) At the same time, the government had compiled an economic policy package with the aims of responding to the downside risks to the economy by mitigating the decline in demand following the rise in the consumption tax rates, and of fostering sustainable economic growth. Specifically, it would first reduce taxes on business fixed investment and on research and development, in addition to carrying out the Action Plan to Implement the Growth Strategy, which was decided on October 1, 2013. The government would also create opportunities, through discussions at the Government-Labor-Management Meeting for Realizing a Positive Cycle of the Economy and the expansion of the income growth promotion tax system, to lead the current economic growth toward increases in wages and in employment and consumption. Moreover, it would formulate economic policy measures totaling 5 trillion yen, which would substantially exceed the amount equivalent to the decline in demand expected to occur during the April-June quarter of 2014. The government would engage in measures to strengthen the competitiveness of the Japanese economy, as well as those for the elderly, women, and young adults, in addition to those on benefits to households with low incomes, and would formulate them by the end of 2013.

(4) Through the aforementioned measures, the government would lay a solid path toward achieving the overcoming of deflation as well as economic revitalization and fiscal consolidation.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on the way to recovery at a moderate pace. As for the outlook, the recovery was expected to take hold as household income and business investment continued to be on upward trends while exports picked up and the effects of a range of policies developed.

(2) The government had taken into comprehensive consideration the economic situation, for example, at the Council on Economic and Fiscal Policy; on October 1, the Cabinet had decided the Consumption Tax Rates and Local Consumption Tax Rates Increase and Accompanying Measures, and confirmed that the consumption tax rates would be

raised from 5 percent to 8 percent on April 1, 2014. At the same time, in order to avoid a stall in the economy caused by raising the consumption tax rates, and to overcome deflation and achieve economic revitalization -- the Cabinet's top-priority tasks -- it also decided an economic policy package that comprised the Action Plan to Implement the Growth Strategy and the formulation of new economic policy measures. On September 20, the government launched the Government-Labor-Management Meeting for Realizing a Positive Cycle of the Economy. The meeting aimed to form a common understanding regarding both the challenge of generating a positive cycle in which improvement in corporate profits would lead to increases in wages and employment, and the efforts that should be made by the respective participants. In order to strongly encourage firms' efforts to raise wages, the government would expand the income growth promotion tax system and, with the idea of leading the current economic growth toward wage increases, it would examine and make a determination in December about whether to end the special corporate tax for reconstruction one year earlier than scheduled. The government deemed that the 2020 Tokyo Olympics and Paralympics would serve as a trigger to eradicate the prolonged deflation and redirect an economy that had been oriented toward contraction, and therefore the government would give maximum support while proceeding with establishing the necessary framework for the success of these events.

(3) While recent price developments as a whole indicated that deflation was ending, the overcoming of deflation was still only halfway accomplished. Therefore, the government deemed it necessary to give particular attention to the developments in prices and a risk that a slowdown in overseas economies would exert downward pressure on the Japanese economy. It expected the Bank to continue its efforts to achieve the price stability target of 2 percent.

VI. Votes

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

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

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

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

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

2. A public statement will be decided separately.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.
Votes against the proposal: None.

VII. Discussion on the Statement on Monetary Policy

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

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T. Kiuchi proposed changing the current expression of the Bank's future monetary policy stance that "the Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" to a new expression that "the Bank will aim to achieve the price stability target of 2 percent in the medium to long term. On this basis, it will designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years, and thereafter will review the monetary easing measures in a flexible manner." The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. T. Kiuchi.

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

B. The Chairman's Policy Proposal

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

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of September 4 and 5, 2013 for release on October 9, 2013.

Attachment
October 4, 2013
Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote, to set the following guideline for money market operations for the intermeeting period:

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

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

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

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

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

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

consumer price index (CPI, all items less fresh food) is in the range of 0.5-1.0 percent. Inflation expectations appear to be rising on the whole.

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

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

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

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

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