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March 14, 2014

Bank of Japan

Minutes of the Monetary Policy Meeting

on February 17 and 18, 2014

(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 Monday, February 17, 2014, from 2:00 p.m. to 4:11 p.m., and on Tuesday, February 18, from 9:00 a.m. to 12:23 p.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. Y. Nishimura, Senior Vice Minister, Cabinet Office[2]
Mr. K. Umetani, Vice Minister for Policy Coordination, Cabinet Office[3]

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

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on March 10 and 11, 2014 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. Furukawa and Y. Nishimura were present on February 18.
[3] Messrs. M. Asakawa and K. Umetani were present on February 17.

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. T. Kawamoto, Senior Economist, Monetary Affairs Department

[4] Messrs. M. Nomura and H. Kamiguchi were present on February 18.

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 January 21 and 22, 2014, 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 196-206 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 recently declined marginally. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been somewhat weak for all maturities. Rates on longer-term interbank instruments had been flat.

Yields on 10-year JGBs had dropped somewhat, partly reflecting declines in U.S. long-term interest rates and Japanese stock prices, and had recently been at around 0.6 percent. While U.S. and European stock prices had declined due to the heightening of investors' risk aversion that reflected nervousness in emerging markets, the Nikkei 225 Stock Average had temporarily fallen by a substantial degree, with the appreciation of the yen, but recovered somewhat thereafter and had recently been in the range of 14,000-14,500 yen. Yield spreads between corporate bonds and JGBs had been narrowing on the whole, albeit very moderately, reflecting solid demand from investors, although some corporate bond spreads had been wide. In the foreign exchange market, the yen had appreciated against the U.S. dollar, coupled with the decline in Japanese stock prices in a situation where investors' risk aversion heightened. The U.S. dollar/yen rate had recently been at around 102 yen.

C. Overseas Economic and Financial Developments

Overseas economies -- mainly advanced economies -- were starting to recover, although a lackluster performance was still seen in part.

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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.

The U.S. economy continued to recover moderately despite the effects of a winter snowstorm, and the recovery had gradually become widespread. Housing investment continued to generally pick up, although the pace had become moderate. Private consumption had been firm, reflecting not only wealth effects but also the continued improving trend in the employment situation. Exports also remained on an increasing trend. Reflecting these developments in demand, business sentiment had been on an improving trend, and production had risen. Moreover, business fixed investment was picking up, albeit moderately. 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 climbed somewhat, mainly because the year-on-year rate of change in energy prices had turned positive.

The European economy had been picking up. Private consumption had been picking up moderately, with consumer sentiment continuing to improve, although the employment and income situation remained severe. Business fixed investment had bottomed out. In addition, there were movements toward a pick-up in exports. Reflecting these developments in demand, production was starting to pick up. As for prices, slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, and the year-on-year rates of increase in both the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food and the HICP for all items had been on a moderate declining trend. Meanwhile, economic activity in the United Kingdom continued to recover, particularly in domestic demand.

With regard to Asia, the Chinese economy continued to see stable growth on the back of firm domestic demand. Stable growth in private consumption continued against the background 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 also remained firm. Moreover, exports had been picking up, particularly those to Europe and the United States. With these developments in demand, production had continued to mark relatively high growth, particularly in the machinery industry, including motor vehicles. Regarding the NIEs and the ASEAN countries, while economic developments in the NIEs were picking up somewhat, growth momentum in the ASEAN countries remained weak. In India, the economy remained in a state of deceleration, particularly in domestic demand. As for prices, there were differences by country and region. Specifically, the year-on-year rate of increase in the CPI had been somewhat low as a trend in China and the NIEs, while that in Indonesia and India continued to be relatively high, mainly reflecting the rise in administered prices.

Global financial markets had been nervous as currencies had depreciated and stock prices had declined, mainly in emerging economies facing structural problems such as current account deficits. U.S. and European stock prices had fallen substantially as investors' risk aversion had spread globally, but had recently risen again. International commodity prices continued to be weak from a relatively longer-term perspective in a situation where emerging economies lacked growth momentum. However, those prices -- crude oil prices in particular -- had been somewhat strong since the previous meeting, partly due to the effects of a winter snowstorm in the United States.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had generally been picking up. On a quarter-on-quarter basis, real exports had turned upward in the January-March quarter of 2013 and grown at an accelerated rate in the April-June quarter. They had fallen in the July-September quarter but risen again in the October-December quarter. Meanwhile, imports continued to increase, mainly due to the effects of the front-loaded increase in demand prior to the consumption tax hike. Exports were expected to increase moderately, mainly against the background of the recovery in overseas economies.

Public investment continued to increase. It was expected to trend upward for the time being and then become more or less flat at a high level.

Business fixed investment had been picking up as corporate profits had improved. Business fixed investment on a GDP basis for the October-December quarter of 2013 rose noticeably compared with the previous quarter. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- continued to increase in both the July-September and October-December quarters of 2013, albeit with monthly fluctuations. Business fixed investment was projected to follow a moderate increasing trend as corporate profits continued to improve.

As for the employment and income situation, supply and demand conditions in the labor market continued to improve steadily, as evidenced by the continued rise in the job openings-to-applicants ratios and the decline in the unemployment rate. Regarding wages, although the year-on-year rate of change in scheduled cash earnings had still been slightly negative, the year-on-year rate of increase in non-scheduled cash earnings had tended to climb, and preliminary figures for special cash earnings in the November-December period of 2013 -- which mostly comprised winter bonuses -- increased markedly. In this situation, employee income had picked up moderately, as it had recently continued to register year-on-year increases.

Private consumption remained resilient, with improvement in the employment and income situation, and a front-loaded increase in demand prior to the consumption tax hike had also been observed. Regarding consumption of durable goods, the number of new passenger-car registrations had turned upward since around summer 2013, and had recently marked a further increase. In addition, sales of household electrical appliances had been steady, albeit with fluctuations. It was likely that such movements in durable consumer goods had been reflecting to some extent the front-loaded increase in demand prior to the consumption tax hike. Private consumption was expected to remain resilient as a trend, supported mainly by improvement in the employment and income situation, albeit with some fluctuations caused by the front-loaded increase and subsequent decline in demand.

Housing investment continued to increase, and the effects of the front-loaded increase in demand prior to the consumption tax hike had been clear. It was expected to remain resilient as a trend, albeit with some fluctuations caused by the hike.

Reflecting these developments in demand both at home and abroad, industrial production had been increasing moderately. Inventories had declined, notably in transport equipment, in view of the front-loaded increase in demand prior to the consumption tax hike. Industrial production was expected to follow a moderate increasing trend, mainly reflecting developments in demand at home and abroad, albeit with some fluctuations caused by the effects of the consumption tax hike.

As for prices, domestic corporate goods prices were rising moderately relative to three months earlier, mainly against the backdrop of movements in international commodity prices and foreign exchange rates. The year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent. With regard to the outlook, excluding the direct effects of the consumption tax hike, domestic corporate goods prices were expected to continue rising moderately for the time being, and the year-on-year rate of increase in the CPI was likely to be around 1¼ percent for some time. Meanwhile, inflation expectations appeared to be rising on the whole.

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 50 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 at around 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. Meanwhile, the year-on-year rate of growth in the money stock had been at around 4.5 percent, mainly due to the increase in bank lending.

II. Amendment to Principal Terms and Conditions for Funds-Supplying Operations against Pooled Collateral in View of the Amendment to the Deposit Insurance Act

A. Staff Reports

Under the amended Deposit Insurance Act, should there be a risk of a severe financial market disruption triggered by events such as a failure of a financial institution, specified bridge financial institutions would be established as subsidiary companies of the Deposit Insurance Corporation of Japan, when considered necessary. The function of specified bridge financial institutions was to take over and fulfill major market transactions -- which had been conducted by the failed financial institutions -- as per their original contract. The necessary liquidity for specified bridge financial institutions was to be provided by the Deposit Insurance Corporation of Japan. Taking this into account, the staff considered it appropriate for the Bank to amend the Principal Terms and Conditions for

Funds-Supplying Operations against Pooled Collateral to exclude specified bridge financial institutions from eligible counterparties for the Bank's various market operations.

Meanwhile, following the transfer of the publisher of LIBOR from the British Bankers' Association to ICE Benchmark Administration Limited completed on February 1, 2014, the staff considered it appropriate for the Bank to amend the rule on loan rates of 6-month U.S. dollar LIBOR under the Special Rules for the U.S. Dollar Lending Arrangement to Enhance the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth.

B. Vote

"Amendment to 'Principal Terms and Conditions for Funds-Supplying Operations against Pooled Collateral,'" which represented the aforementioned amendments, was put to a vote. Members voted unanimously to approve the amendment. They concurred that the staff should accordingly make this public after the meeting.

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 been nervous as stock prices had declined and currencies had depreciated, mainly in emerging economies facing structural problems such as current account deficits, and that the effects of such developments had been spreading even to advanced countries. A few members pointed out that recent adjustments in stock prices worldwide had been affected by position adjustments made by investors, and that they could be considered largely as a reversal of a surge in stock prices seen toward the end of 2013. One member said that, in emerging markets, stocks and currencies of countries facing issues such as current account deficits had been sold in a selective manner. Members agreed that, although emerging markets had most recently gradually started to regain their calmness, mainly in Asian economies with favorable economic fundamentals, it was necessary to continue to closely monitor market developments, including the effects of the Federal Reserve's reduction in the pace of its asset purchases.

Members concurred that overseas economies -- mainly advanced economies -- were starting to recover, although a lackluster performance was still seen in part of the emerging economies. As for the outlook, they shared the recognition that overseas economies -- mainly advanced economies -- would recover moderately. Many members added that they maintained their view that, compared to before, downside risks to overseas economies as a whole remained diminished, although developments in emerging and commodity-exporting economies in particular continued to warrant attention.

With regard to developments in overseas economies by region, members agreed that the U.S. economy continued to recover moderately, although some economic indicators showed that the economy had been affected by a winter snowstorm, and that the recovery had gradually become widespread. Many members said that the employment situation generally remained on its improving trend considering that, for example, (1) although the recent pace of increase in payroll employment had slowed, it was necessary to take into account fluctuations in statistics; and (2) the unemployment rate, which was measured by the household survey, had been declining. In relation to this, a few members noted that due attention should be paid to the point that the long-term declining trend in the labor force participation rate had contributed to a significant extent to the decline in the unemployment rate in recent years. As for the outlook, members shared the view that the pace of economic recovery would gradually rise, as the debt ceiling problem had settled and the fiscal drag was projected to fade. One member mentioned the possibility that, in the January-March quarter of 2014, U.S. economic activity could be relatively weak due to the effects of a winter snowstorm, while in the April-June quarter the growth momentum could strengthen due to a reversal of the previous quarter's movements. This member continued that, in such a case, movements in the U.S. economy could work toward offsetting the slowdown in Japan's economy following the consumption tax hike.

Members shared the recognition that economic activity in the euro area had been picking up. A few members pointed out that the pick-up had begun to spread, as shown by the fact that, for example, household and business sentiment had improved and the real GDP growth rate for the October-December quarter of 2013 had registered positive growth for the third consecutive quarter. As for the outlook, members concurred that the economy was likely to continue picking up as domestic demand was expected to do so as well, and as exports would likely recover moderately. A few members, however, pointed out that attention should be paid to (1) the possibility that the disinflationary trend would become prolonged due to continuous pressures to adjust wages in a situation where there was slack in supply and demand conditions in the labor market, as well as (2) the risk of disinflation compounding the European debt problem.

Members agreed that the Chinese economy continued to see stable growth on the back of firm domestic demand. Some members commented that it had been difficult to accurately grasp the underlying trend in Chinese economic indicators for the January-February period of 2014, due to the effects of the Chinese New Year. As for the outlook, most members expressed the view that the economy would maintain stable growth at around the current pace as authorities would likely continue to pay consideration to economic activity while progressing with structural reforms, and external demand was expected to continue improving moderately. Many members added that careful attention should continue to be paid to how the shadow banking problem would affect the financial system.

Regarding the NIEs and the ASEAN countries, members concurred that, while economic activities in the NIEs were picking up, growth momentum in the ASEAN countries remained weak. Some members pointed out that exports from South Korea and Taiwan showed signs of picking up due to the improvement in advanced economies. As for the outlook for the NIEs and the ASEAN countries, members shared the recognition that, for the time being, an adjustment phase would continue -- especially in the ASEAN countries -- and the pace of economic growth in the NIEs and the ASEAN countries would likely remain relatively slow. They continued that the pace would rise again, however, as growth in advanced economies was expected to gain momentum over time.

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

With regard to economic activity, members shared the view that, as a virtuous cycle among production, income, and spending continued to operate, the economy continued to recover moderately, and a front-loaded increase in demand prior to the consumption tax hike had recently been observed. Regarding real GDP for the October-December quarter of 2013, some members said that net exports had pushed down the GDP growth rate, mainly due to the relatively high growth in imports. At the same time, however, these members pointed out that the economy continued to grow at a pace above its potential on the back of firmness in domestic demand. As for the outlook for the economy, members shared the view that it was likely to continue its moderate recovery as a trend, while it would be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike. A few members expressed the view that future economic developments depended on whether an increase in exports and business fixed investment could offset the reversal decline in private consumption following the consumption tax hike. One of these members added that, in the event of a decline in household and business sentiment, it was necessary to closely monitor whether this would bring about a self-fulfilling economic downturn through a contraction in consumption and investment activities.

Members shared the recognition that, as overseas economies -- mainly advanced economies -- were starting to recover, Japan's exports had generally been picking up, albeit with fluctuations, although there continued to be a lack of momentum with weakness remaining in exports to some emerging countries including the ASEAN countries. As for the outlook, they agreed that exports were likely to increase moderately, mainly against the background of the recovery in overseas economies. Some members said that, behind the lack of momentum in exports despite the earlier depreciation of the yen, structural factors -- including the shift of Japanese firms' production sites to overseas accompanying increased local procurement by Japanese manufacturers -- might be at work. One of these members added that an increase in manufacturers' capability to earn profits overseas could have positive effects, particularly by inducing an increase in national savings and net assets, through an improvement in the balance of income. Some members pointed out that, in some sectors, while firms seemed to place priority on domestic shipments in response to firm domestic demand, export shipments had been contained. These members continued that exports might gain momentum in the April-June quarter of 2014, at which time domestic demand was projected to experience a reversal decline following the consumption tax hike.

A few members pointed out that imports had recently continued to mark relatively high growth, reflecting firm domestic demand including the effects of a front-loaded increase in demand prior to the consumption tax hike and of replacement demand for personal computers.

Members concurred that business fixed investment had been picking up as corporate profits had improved, and was projected to follow a moderate increasing trend. With regard to machinery orders, many members noted that the significant decline in December 2013 could be largely attributable to a reversal of the earlier increase, and that they were judged to be on an increasing trend with monthly fluctuations taken into consideration. A few members commented that it was a matter of concern that the forecast figures for machinery orders for the January-March quarter showed a small decline.

As for the employment and income situation, members shared the recognition that supply and demand conditions in the labor market continued to improve steadily, and that employee income had also picked up moderately. As for the outlook regarding employee income, they agreed that a pick-up was likely to become more evident, in line with the recovery in economic activity and business performance. One member noted that due attention needed to be paid to the fact that, although the number of employees continued to increase, this increase was mainly in part-time employees. Furthermore, a different member pointed out that, since the active job openings-to-applicants ratio for regular employees was lower than the ratio for the total number of employees including part-time employees, the wages of regular employees had been less likely to increase. Counter to this, one member noted that, given Japan's employment practices, it could be expected that the number of regular employees would rise from April, when new graduates would be recruited. Moreover, a different member commented that, even if a tightening of supply and demand conditions in the labor market was mainly seen for part-time employees, upward pressure on wages could heighten on the whole. As for the outlook for wages, some members expressed the intent to pay close attention to the outcome of wage negotiations to be held this spring. One member expressed the view that the termination of the measures for the reduction of salaries of government employees as of the end of fiscal 2013 could work toward boosting wages -- including a rise in wages of those engaged in medical and social welfare as well as education, which were linked to salaries of local government employees.

Members shared the recognition that private consumption remained resilient, with improvement in the employment and income situation, and a front-loaded increase in demand prior to the consumption tax hike had also been observed. They agreed that it was likely that the movements in consumption of durable consumer goods such as motor vehicles and household electrical appliances had been reflecting to some extent the front-loaded increase in demand prior to the consumption tax hike, in addition to the improvement in the employment and income situation evidenced by the increase in winter bonus payments. Members concurred that private consumption was likely to remain resilient as a trend, supported mainly by improvement in the employment and income situation, albeit with some fluctuations caused by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike. Some members -- while noting the relatively weak developments in consumer confidence since October 2013 -- said that this might be attributable to consumers' awareness of the consumption tax hike, and future developments warranted attention. In relation to this, one member said that the breakdown of the consumer confidence index showed that consumer perception of "income growth" and "overall livelihood" was deteriorating recently. This member expressed the view that it was therefore necessary to be aware of the slowdown in the pace of improvement in the employment and income situation as a downside risk to consumption. In response to this view, one member pointed to the fact that consumer perception of "employment" in the consumer confidence index remained on an improving trend, and expressed the opinion that abatement of employment uncertainty led to a containment in precautionary savings, thereby underpinning the mechanism for self-sustained economic recovery led mainly by consumption and nonmanufacturers.

Members agreed that industrial production had been increasing moderately, reflecting these developments in demand both at home and abroad, and that this was likely to continue as a trend.

Regarding prices, members shared the view that the year-on-year rate of increase in the CPI (all items less fresh food) was around 1¼ percent and the rate of increase, excluding the direct effects of the consumption tax hike, was likely to be around 1¼ percent for some time. Many members said that price rises had been observed not only in energy-related goods but also across a wide range of items, as evidenced by the fact that the year-on-year rate of increase in the CPI (all items less food and energy) for December 2013 had risen to 0.7 percent. Many members pointed out that, on the back of resilience in private consumption and an improvement in the aggregate supply and demand balance, firms continued to find it easy to pass on costs to sales prices. On this point, one member added that, although the recent rise in the inflation rate was sometimes explained as a type of cost-push inflation caused by the depreciation of the yen, setbacks in production that usually took place in cases of cost-push inflation were not actually being observed. Meanwhile, one member pointed to the possibility that the effects of the depreciation of the yen on prices had become larger. Members shared the recognition that inflation expectations appeared to be rising on the whole, considering market indicators, the results of various surveys, and other information.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative. They shared the view that the monetary base had increased significantly, reflecting the progress in asset purchases by the Bank, and that firms' funding costs had been hovering at low levels. Members agreed that firms continued to see financial institutions' lending attitudes as being on an improving trend. They also concurred that the year-on-year rate of growth in the money stock had been on a rising trend in a situation where the amount outstanding of bank lending, including that to small firms, had been increasing moderately.

IV. Summary of Staff Reports on the Fund-Provisioning Measure to Stimulate Bank Lending and Other Measures

As the fund-provisioning measure to stimulate bank lending (hereafter the Stimulating Bank Lending Facility) and other measures were due to expire shortly, the staff provided the following explanation regarding the outline and usages of the measures under the current framework.

In a situation where the year-on-year rate of increase in the amount outstanding of bank lending had climbed to around 2.5 percent, financial institutions -- mainly major banks -- had made active use of the Stimulating Bank Lending Facility and the amount outstanding of Bank's fund-provisioning was currently around 5 trillion yen. This facility had been providing financial institutions with the means to raise long-term funds at a low fixed interest rate, and they had been making use of it even as a means to carry out asset-liability management (ALM). As for the fund-provisioning measure to support strengthening the foundations for economic growth (hereafter the Growth-Supporting Funding Facility), the amount outstanding of the Bank's fund-provisioning under the main rules had been around 3.2 trillion yen, almost reaching the maximum amount of 3.5 trillion yen. Some financial institutions had been making use of this facility close to the maximum amount that could be provided to each of them -- namely, 150 billion yen. The amounts of the Bank's fund-provisioning under the special rules for equity investments and asset-based lending (ABL) and under the special rules for small-lot investments and loans had been about 100 billion yen and about 7 billion yen, respectively, while the maximum amount of the Bank's fund-provisioning was 500 billion yen under each rule. Financial institutions had actively been making use of this facility; for example, for establishing loan funds that relied on this facility as a funding source. Of the maximum amount of the Bank's fund-provisioning -- that is, 1 trillion yen -- under the funds-supplying operation to support financial institutions in disaster areas, about 400 billion yen had been used.

V. Summary of Discussions on Monetary Policy for the Immediate Future and the Treatment of the Stimulating Bank Lending Facility and Other Measures

A. 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 Japan real estate investment trusts (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 maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

With respect to the Bank's thinking behind its conduct of monetary policy, most members shared the recognition 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. Members expressed the view that it was appropriate for the Bank to continue to steadily pursue quantitative and qualitative monetary easing in accordance with the current guidelines, taking into account that Japan's economic and price developments had been broadly in line with the forecasts presented in October 2013 and that risks -- particularly those surrounding overseas economies -- had decreased.

On the other hand, one member said that, 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 in a situation where it was unlikely that the price stability target would be achieved in about two years, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, the 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. This member added that the Bank needed to make constant efforts to conduct an assessment with regard to "the second perspective" -- that is, an examination of the risks considered most relevant to the conduct of monetary policy.

With regard to <u>the effects of quantitative and qualitative monetary easing</u>, members shared the recognition that these continued to firmly take hold, and financial conditions were easing steadily to underpin firms' and households' spending. Regarding how much of an effect could be exerted on longer-term interest rates, they agreed that long-term interest rates in Japan had been stable at low levels under the Bank's massive JGB purchases. Members shared the recognition 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.

B. Treatment of the Stimulating Bank Lending Facility and Other Measures

As the Stimulating Bank Lending Facility and other measures were due to expire shortly, members discussed whether these should be extended and, if so, what their content and size should be.

With regard to the funds-supplying operation to support financial institutions in disaster areas, members agreed that, in order to continue supporting the efforts of financial institutions toward rebuilding disaster areas affected by the Great East Japan Earthquake, it was appropriate for the Bank to extend the operation, together with the temporary rules regarding the relaxation of the collateral eligibility standards for the debt of companies in these areas, by one year.

Regarding the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility, many members expressed the opinion that the Bank could extend the deadlines for new applications under these facilities by one year, based on the recognition that financial institutions' efforts to increase lending and strengthen the growth potential of Japan's economy were vital to overcoming deflation. On this basis, many members said that the Bank could decisively enhance the facilities in terms of the size and duration of fund-provisioning, with a view to even further promoting financial institutions' actions as well as significantly stimulating firms' and households' demand for credit and demonstrating the Bank's "strong intention." Specifically, as for the maximum amount of the Bank's fund-provisioning under the Stimulating Bank Lending Facility, some members expressed the view that, considering that financial institutions -- mainly major banks -- were currently making active use of this facility, the Bank could raise the amount up to twice as much as the net increase in their lending, thereby providing them with a greater incentive. In terms of the size of the Growth-Supporting Funding Facility, some members said that it was appropriate for the Bank to set an amount that would be fully sufficient for financial institutions to make efforts toward strengthening the growth potential of Japan's economy. As for the duration of fund-provisioning under the two facilities, a few members were of the view that, if the Bank extended the duration of its fund-provisioning at a fixed rate of 0.1 percent per annum from the current "one to three years" to "four years," this was expected to lead to an increase in financial institutions' capacity to take interest rate risks. One of these members said that, if each year financial institutions had an option to make a prepayment, this, together with an extension of the duration of the Bank's fund-provisioning to four years, could allow financial institutions to adjust the size of their balance sheets flexibly.

Based on this discussion, members shared the recognition that it was appropriate for the Bank to make the following revisions to the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility: (1) the deadlines for new applications under these facilities would be extended by one year; (2) the maximum amounts of the Bank's fund-provisioning under these facilities would be doubled; and (3) the duration of its fund-provisioning at a fixed rate of 0.1 percent per annum would be extended from the current "one to three years" to "four years."

With respect to the significance of revisions to the framework for the Stimulating Bank Lending Facility and other measures, some members noted that it was vital for the large scale monetary base provided under quantitative and qualitative monetary easing to be utilized by financial institutions in their efforts to increase lending and strengthen the growth potential of Japan's economy, and that the revisions discussed at this meeting would strengthen the transmission mechanism of the effects of quantitative and qualitative monetary easing. Many members said that the Bank had been stating that, in implementing quantitative and qualitative monetary easing, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. These members continued that the revisions discussed at this meeting should not be taken as such "adjustments" given that Japan's economy was following a path toward achieving the price stability target of 2 percent as expected. One member noted that, in communicating to the public, caution was required to avoid causing speculation that the one-year extension of the deadlines for new applications under the Stimulating Bank Lending Facility and other measures, as well as the Bank's fund-provisioning at a fixed rate of 0.1 percent per annum for four years, had any relationship to the time frame for continuing quantitative and qualitative monetary easing. This member added that attention should also be paid to possible effects on financial institutions' future financial soundness, including the possibility of intensifying their lending competition. Meanwhile, one member commented that, making effective use of this opportunity, the Bank might consider further enhancing its communication to the public regarding the advantages of the Stimulating Bank Lending Facility, given that regional banks were currently making less use of the facility than major banks.

VI. Remarks by Government Representatives

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

(1) The Japanese economy continued to grow steadily, as evidenced by the fact that the real GDP growth rate for the October-December quarter of 2013 was 1.0 percent on an annualized quarter-on-quarter basis, registering positive growth for the fourth consecutive quarter. Prices had been resilient, as seen in the fact that the year-on-year rate of increase in the CPI for all items less fresh food for 2013 was 0.4 percent, turning positive for the first time in five years. Nevertheless, the overcoming of deflation was still only halfway accomplished, and therefore the government 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 supplementary budget for fiscal 2013 had been approved by the Diet on February 6, 2014. In order to avoid a greater-than-expected slowdown in the Japanese economy after the consumption tax hike and swiftly get the Japanese economy back on a growth path, the Minister of Finance had called for each minister to promptly and steadily implement measures in the Economic Measures for Realization of Virtuous Cycles, including those in the aforementioned supplementary budget, through, for example, making efforts to swiftly and smoothly carry out public construction so that they would produce appropriate effects within the first half of fiscal 2014. As for the tax reform in fiscal 2014, the government, in line with the outline for tax reform decided by the Cabinet at the end of 2013, had submitted to the Diet (1) bills to amend the Income Tax Act and other laws, in order to implement measures such as tax breaks for capital investment and the expansion of the tax incentives for income growth, and (2) a bill on regional corporate tax in an effort to correct the uneven distribution of tax revenue sources among regions. The government would work to promptly obtain the Diet's approval of these bills, together with the budget for fiscal 2014, which was currently being deliberated.

(3) With a view to promoting social security system reform, the government had set up the Headquarters for the Promotion of Social Security System Reform comprised of relevant ministers, including the Prime Minister, in accordance with a law enacted in 2013 that presented an overall picture of social security reform and a time frame for implementing the reform. In order to make social security sustainable, striking a

balance between benefits and burdens, the relevant ministers would work together to proceed with reforms under the leadership of the Prime Minister.

(4) Through a series of the aforementioned measures, including those geared toward materializing the growth strategy, the government would do its utmost to realize a virtuous cycle of overcoming deflation, revitalizing the economy, stabilizing the social security system, and achieving fiscal consolidation.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was recovering at a moderate pace. The real GDP growth rate registered positive growth for the fourth consecutive quarter, in the October-December quarter of 2013. As for the outlook, the economy was expected to be on a recovery trend as household income and business investment increased, supported by a picking up of exports and the effects of a range of policies. The government would also closely monitor recent developments in financial markets -- particularly in emerging economies -- and their effects.

(2) Following the passing of the supplementary budget, the Prime Minister had given instructions to implement swiftly the Economic Measures for Realization of Virtuous Cycles and to manage its progress. The government would work so that each of these economic measures would produce effects within the first half of fiscal 2014, thereby boosting economic growth through the following efforts: (1) a request by the Ministry of Internal Affairs and Communications to local governments for swift implementation of the measures; (2) implementation of measures to ensure the smooth execution of public works construction projects and raising of the unit price of labor relating to public construction and design projects by the Ministry of Land, Infrastructure, Transport and Tourism; and (3) a survey on progress of the economic measures by the Cabinet.

(3) In order to overcome deflation and revitalize the economy, the government deemed it important to lead the upturn in corporate profits toward increases in wages. Specific wage levels would be decided through individual labor-management negotiations. The government expected wage increases to occur as serious discussion had taken place in the course of the spring wage negotiations this year.

(4) With a view to improving the current account balance through the improvement in the trade balance and the increase in the surplus in the income balance by strengthening Japan's industrial competitiveness, the government would further enhance the growth strategy. It planned to proceed with deregulation, for example, by designating specific regions as the National Strategic Special Zones in March 2014, and to decide on a course toward employing foreign workers in the construction industry. In order to develop a favorable environment for business and attract more investment to Japan, the government would deliberate on how to set the effective corporate tax rate while cooperating with the ruling parties and the Government Tax Commission.

(5) The Japanese economy was no longer at the stage of deflation, but the overcoming of deflation was only halfway accomplished. The government deemed the Bank's proposal made at this meeting to enhance the framework for the Stimulating Bank Lending Facility and other measures to be a timely action. It expected the Bank to continue its efforts to achieve the price stability target of 2 percent.

VII. Votes

A. Vote on the Guideline for Money Market Operations

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

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

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

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

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

2. A public statement will be decided separately.

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

Votes against the proposal: None.

B. Vote on "Release of 'Outline of the Enhanced Framework for the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility'"

The chairman formulated a proposal to release "Outline of the Enhanced Framework for the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility" (see Attachment 2), which presented the content of the extension and enhancement of the Stimulating Bank Lending Facility as well as the Growth-Supporting Funding Facility, and put it to a vote. The Policy Board decided the proposal by a unanimous vote.

C. Vote on "Amendment to 'Principal Terms and Conditions for the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas' and 'Temporary Rules regarding the Eligibility Standards for Debt of Companies in Disaster Areas'"

The chairman formulated a proposal to extend the funds-supplying operation to support financial institutions in disaster areas and the temporary rules regarding the eligibility standards for debt of companies in disaster areas by one year, and put it to a vote. The Policy Board decided the proposal by a unanimous vote, and agreed that the decision should be made public accordingly.

VIII. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy, which included (1) an outline of the enhanced framework for the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility and (2) a description of the extension of the funds-supplying operation to support financial institutions in disaster areas, and formed a majority view. Mr. T. Kiuchi, however, formulated a proposal, and thus two proposals were submitted.

Meanwhile, Ms. S. Shirai expressed dissent from the description regarding risks to the outlook presented in the draft of the statement that formed a majority view, suggesting that the pace of improvement in the employment and income situation in Japan should be added. As the reason for this, she stated that, for domestic demand to maintain its firmness in the future, it was important for the employment and income situation to continue improving; therefore, considering the existence of recent indicators that showed a deterioration in households' income outlook, this issue should be included as one of the risks for the time being.

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 1).

IX. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of January 21 and 22, 2014 for release on February 21, 2014.

Attachment 1

February 18, 2014

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 maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen respectively.

3. The Policy Board also decided, by a unanimous vote, to double the scale of (i) the Fund-Provisioning Measure to Stimulate Bank Lending (hereafter "Stimulating Bank Lending Facility") and (ii) the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth (hereafter "Growth-Supporting Funding Facility"), and to extend the application period for these facilities by one year.[1] Before today's decision, these were due to expire shortly.

   Specifically, under the Stimulating Bank Lending Facility, financial institutions will be able to borrow funds from the Bank up to an amount that is twice as much as the net increase in their lending. As for the Growth-Supporting Funding Facility, the maximum amount of the

[1] See Attachment 2 for details.

Bank's fund-provisioning under the main rules will be doubled from 3.5 trillion yen to 7 trillion yen. Under these facilities, financial institutions will be able to borrow funds at a fixed rate of 0.1 percent per annum for 4 years instead of 1-3 years at present.

The Bank expects that these enhancements will further promote financial institutions' actions as well as stimulate firms' and households' demand for credit, with a view to encouraging banks' lending and strengthening the foundations for economic growth.

4. Furthermore, the Policy Board decided, by a unanimous vote, to extend the Funds-Supplying Operation to Support Financial Institutions in Disaster Areas affected by the Great East Japan Earthquake and the Temporary Rules regarding the Eligibility Standards for Debt of Companies in Disaster Areas by one year.

5. Japan's economy has continued to recover moderately, and a front-loaded increase in demand prior to the consumption tax hike has recently been observed. Overseas economies -- mainly advanced economies -- are starting to recover, although a lackluster performance is still seen in part. 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. With improvement in the employment and income situation, housing investment has continued to increase and private consumption has remained resilient; in these segments of the economy, the front-loaded increase in demand prior to the consumption tax hike has also been observed. Reflecting these developments in demand both at home and abroad, industrial production has been increasing moderately. Meanwhile, financial conditions are accommodative. On the price front, the year-on-year rate of increase in the consumer price index (CPI, all items less fresh food) is around 1¼ percent. Inflation expectations appear to be rising on the whole.

6. With regard to the outlook, Japan's economy is expected to continue a moderate recovery as a trend, while it will be affected by the front-loaded increase and subsequent decline in demand prior to and after the consumption tax hike. The year-on-year rate of increase in the CPI, excluding the direct effects of the consumption tax hike, is likely to be around 1¼ percent for some time.

7. Risks to the outlook include developments in the emerging and commodity-exporting economies, the prospects for the European debt problem, and the pace of recovery in the U.S. economy.[Note 1]

8. 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 2]

   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 1] Ms. S. Shirai dissented from the description in paragraph 7, suggesting that the pace of improvement in the employment and income situation in Japan should be added.

[Note 2] 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.

Attachment 2

Outline of the Enhanced Framework for the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility[Note 1]

1. Stimulating Bank Lending Facility

   A. The deadline for new applications under the facility shall be extended by one year.[Note 2]

   B. The maximum amount of the Bank's fund-provisioning to each financial institution shall be an amount that is twice as much as the net increase in its lending.[Note 3]

   C. The interest rate applied to the facility shall be fixed at 0.1 percent per annum for four years. Financial institutions have an option to make prepayment every year.

2. Growth-Supporting Funding Facility

   A. The deadline for new applications under the main rules as well as special rules for equity investments and asset-based lending, small-lot investments and loans, and the U.S. dollar lending arrangement shall be extended by one year.[Note 4]

   B. The maximum amount of the Bank's fund-provisioning under the main rules shall be doubled from 3.5 trillion yen to 7 trillion yen. The maximum amount of its fund-provisioning to each financial institution shall be increased from 150 billion yen to 1 trillion yen.

[Note 1] Amendments to relevant principal terms and conditions will be decided at the next Monetary Policy Meeting.

[Note 2] The disbursement under the current framework shall end in March 2014. The disbursement after June 2014 shall be based on the new framework (1.B. and C. mentioned above). Unused amount under the current framework cannot be carried over to the new framework. Under the new framework, unused amount at the time of disbursement cannot be carried over to subsequent disbursements.

[Note 3] Based on the assumption that the growth rate of bank lending and the utilization rate of this facility remain more or less at current levels, the amount outstanding of fund-provisioning under this facility is estimated to be around 30 trillion yen.

[Note 4] The disbursement under the new framework (2.B. and C. mentioned above) will begin in June 2014.

C. The interest rate applied to the facility under the main rules and special rules for equity investments and asset-based lending, and small-lot investments and loans shall be fixed at 0.1 percent per annum for four years. Financial institutions have an option to make prepayment every year.