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Minutes of the Monetary Policy Meeting on January 21 and 22, 2009

Bank of Japan/Central Bank of Japan

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February 24, 2009

Bank of Japan

Minutes of the Monetary Policy Meeting

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(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 Wednesday, January 21, 2009, from 2:00 p.m. to 5:17 p.m., and on Thursday, January 22, from 8:30 a.m. to 1:38 p.m.[1]

Policy Board Members Present

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

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

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

Ms. M. Suda

Mr. A. Mizuno

Mr. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Government Representatives Present

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

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

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

Reporting Staff

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

Mr. K. Ido, Executive Director

Mr. K. Yamamoto, Executive Director

Mr. H. Nakaso, Executive Director[4]

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on February 18 and 19, 2009 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Mr. W. Takeshita was present on January 22.

[3] Mr. C. Kawakita was present on January 21.

[4] Mr. H. Nakaso concurrently held the post of Director-General of the Financial Markets Department.

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

Mr. M. Ayuse, Associate Director-General, Monetary Affairs Department[5]

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

Mr. K. Momma, Director-General, Research and Statistics Department

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

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

Secretariat of the Monetary Policy Meeting

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

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

Mr. T. Kato, Senior Economist, Monetary Affairs Department

Mr. T. Sakamoto, Director, Head, Monetary Operations Planning, Monetary Affairs Department[5]

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

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

[5] Messrs. M. Ayuse and T. Sakamoto were present on January 22.

I. Summary of Staff Reports on Economic and Financial Developments[6]

A. Money Market Operations in the Intermeeting Period

The Bank conducted money market operations in accordance with the guideline decided at the previous meeting on December 18 and 19, 2008.[7] The uncollateralized overnight call rate had been at around 0.1 percent.

To ensure market stability in Japan, the Bank provided more funds maturing over the year-end and actively purchased Japanese government securities and CP under repurchase agreements. Moreover, the Bank continued to conduct U.S. dollar funds-supplying operations against pooled collateral and on January 8, 2009 started to conduct special funds-supplying operations to facilitate corporate financing.

B. Recent Developments in Financial Markets

Japan's money market had been nervous. While the general collateral (GC) repo rates as well as yields on treasury bills (TBs) and financing bills (FBs) had generally declined, the risk premium on Euroyen rates remained at an elevated level. The CP market generally remained tight, although interest rates on CP had declined somewhat since late December as (1) firms' seasonal demand for funds over the year-end had dropped, (2) the Development Bank of Japan Inc. had started outright purchases of CP, and (3) the Bank of Japan had decided to introduce such purchases.

Japanese stock prices had been unstable at low levels, mainly reflecting the bleak outlook for corporate profits. The Nikkei 225 Stock Average had declined to around 8,000 yen recently. Long-term interest rates in Japan declined temporarily to the 1.1-1.2 percent level in late December, reflecting decreases in U.S. and European long-term interest rates due mainly to deterioration in the outlook for the world economy, and had recently been in the range of 1.20-1.25 percent.

The yen depreciated temporarily to the level of 94-95 yen against the U.S. dollar in early January as the dollar was bought on expectations about the economic stimulus plan that would be put forth by the new administration in the United States. The yen had since

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

[7] The guideline was as follows:

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

appreciated, to around 89-90 yen against the dollar, mainly reflecting the deterioration in indicators relating to employment and private consumption in the United States and the fall in U.S. stock prices.

C. Overseas Economic and Financial Developments

U.S. economic conditions had deteriorated significantly. A substantial decline in housing investment continued, and home prices continued to fall. Private consumption and business fixed investment continued to decrease. In this situation, industrial production had been decreasing and the number of employees had been declining considerably. Funding conditions for firms and households had remained tight. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items had declined significantly, to close to 0 percent, due to a fall in energy prices and a leveling-off of increases in food prices; that in the CPI for all items less energy and food, or the core CPI, had also declined.

Economic conditions in the euro area had deteriorated significantly. Exports had declined sharply, while private consumption, business fixed investment, and housing investment had decreased. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) had been declining. Economic conditions in the United Kingdom had also deteriorated significantly, mainly reflecting the considerable adjustments in the housing market and a decrease in private consumption.

Deceleration in the Chinese economy had become evident: although domestic demand continued to show high growth, exports had declined sharply. Economic growth in India had decelerated, and that in the NIEs and the ASEAN countries had been sluggish. As for prices, the year-on-year rate of increase in the CPI had declined in many Asian economies.

Global financial markets generally remained under strain, although there was a slight improvement in some markets, such as money markets. Although Treasury-Eurodollar (TED) spreads had narrowed to close to their levels immediately before the failure of Lehman Brothers Holdings Inc., credit spreads on corporate bonds, particularly those with low ratings, had remained wide, and new funding of firms had been low. U.S. and European stock prices rose temporarily on expectations about economic stimulus plans, but had generally declined against the background of deterioration in economic indicators and concerns about business performance. U.S. long-term interest rates had risen slightly due to concerns about a possible increase in the issuance of government bonds, while European long-term interest rates had been more or less flat.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had decreased substantially. They were expected to continue decreasing for the time being, due to the slowdown in overseas economies and the appreciation of the yen.

With regard to domestic private demand, business fixed investment had declined substantially, mainly due to the decrease in corporate profits. It was likely to continue declining significantly for the time being, given the slowdown in overseas economies and the ongoing decrease in corporate profits as well as the deterioration in firms' funding conditions.

Private consumption had weakened, as the employment and income situation had become increasingly severe. The decrease in the number of new passenger-car registrations had accelerated. Sales at department stores had softened further, since consumers had further curtailed their purchases. Consumer sentiment had deteriorated further, mainly due to the drop in stock prices and growing employment uncertainty; indicators of consumer sentiment had fallen to around or below their levels at the time of the previous economic downturn. Private consumption was likely to continue weakening for the time being, as the employment and income situation would become increasingly severe.

Housing investment had been more or less flat. The number of housing starts, which was a leading indicator of housing investment and had been more or less flat from the beginning of 2008, had recently started to decrease again. Housing investment was expected to weaken somewhat for the time being, given the sluggishness in housing starts.

Production had decreased at a much faster pace. It was likely that production would continue to decrease for the time being, since the weakness in domestic and external demand had become more evident and inventory adjustment pressures had increased. Inventories had risen noticeably, while shipments had decreased substantially; the shipment-inventory balance had therefore deteriorated rapidly.

As for employment and income, household income had been relatively weak, as the year-on-year rate of change in nominal wages per worker had become negative. Household income was likely to continue declining for the time being in response to the decrease in corporate profits and production.

On the price front, commodity prices, which peaked in summer 2008 and dropped substantially thereafter, had recently been essentially flat at low levels. The three-month rate of decrease in the domestic corporate goods price index (CGPI) had been large and the CGPI was likely to continue decreasing for the time being, mainly due to the declines in commodity prices. The year-on-year rate of increase in the CPI (excluding fresh food) had moderated to around 1 percent, mainly reflecting the declines in the prices of petroleum products and the stabilization of food prices. It was expected to moderate further and become negative by the spring, mainly due to the above factors and also to increasing slackness in supply and demand conditions in the overall economy.

2. Financial environment

Financial conditions had become tighter. The overnight call rate had been at an extremely low level, but the stimulative effects from this had become increasingly limited given the significant deterioration in economic activity. Despite a slight decline in bank lending rates following the reductions in the policy interest rate, funding costs for firms had been more or less flat as a whole, as credit spreads on CP and corporate bonds had remained wide. The amount outstanding of CP and corporate bonds issued had been below the previous year's level, as investors had continued to be selective in their purchases of them. The amount outstanding of bank lending, particularly to large firms, had increased at a faster pace reflecting firms' need to secure more liquidity and to compensate for the decline in the issuance of CP and corporate bonds. Despite the increase in bank lending, an increasing number of firms had reported that their financial positions were weak and lending attitudes of financial institutions were severe. The year-on-year rate of change in the money stock (M2) had been around 2 percent.

II. Amendments to Principal Terms and Conditions for the Outright Purchase/Sale of Japanese Government Bonds (JGBs)

A. Staff Proposal

The staff would like to propose that the Bank amend Principal Terms and Conditions for the Outright Purchase/Sale of Japanese Government Bonds so as to be able to conduct a multiple-price competitive auction, where counterparties bid in terms of "price spreads" (calculated by subtracting the benchmark prices from the prices at which counterparties wished to sell bonds to the Bank), for outright purchases of floating-rate bonds and inflation-indexed bonds, which were added to the list of JGBs eligible for the Bank's outright purchases by the Policy Board's decision at the previous Monetary Policy Meeting held on December 18 and 19, 2008. As for the scheme to purchase JGBs of specific types and residual maturities, the introduction of which was decided at the previous meeting, the staff would like to make public a finalized plan specifying details such as the amounts to be purchased from different types and maturity brackets.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the proposal to amend Principal Terms and Conditions for the Outright Purchase/Sale of Japanese Government Bonds and agreed that the decision should be made public.

III. Amendments to Principal Terms and Conditions for Money Market Operations

A. Staff Proposal

In line with the integration of TBs and FBs to form "treasury discount bills," which would be issued by the Ministry of Finance from February 2009, the staff would like to propose that the Bank make necessary amendments to Principal Terms and Conditions for the Outright Purchase/Sale of Short-Term Japanese Government Securities and other rules and regulations related to the integration.

B. Discussion by the Policy Board and Vote

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

IV. Summary of Staff Reports on Basic Principles regarding Additional Measures to Facilitate Corporate Financing

At the Monetary Policy Meeting held on December 18 and 19, 2008, the chairman instructed the Bank's staff to examine additional measures to facilitate corporate financing, including outright purchases of CP. In response to the instruction, the staff reported at this meeting on the basic principles regarding outright purchases of corporate financing instruments to facilitate corporate financing and actions that could be taken based on these principles.

Outright purchases of corporate financing instruments to facilitate corporate financing should be regarded as an exceptional measure for a central bank for the following reasons. First, they involved taking on a greater degree of individual private firms' credit risk and consequently a relatively high probability of incurring losses that would ultimately be borne by the taxpayer and deepened the involvement of the Bank in microeconomic resource allocation among individual firms. And second, they involved a higher risk, compared to other policy measures, of damaging the financial health of the Bank as a result of losses incurred and ultimately undermining confidence in the currency and monetary policy.

Outright purchases of corporate financing instruments should be implemented only when, first, a significant decline in the functioning of the market for corporate financing instruments had been observed, and it had led to tight overall corporate financing conditions, and second, outright purchases by the Bank of corporate financing instruments were judged necessary to improve the situation in light of the Bank's mission.

In the implementation of such outright purchases, the following points should be considered: (1) preventing the purchases from constituting an arbitrary allocation of funds to particular firms; (2) conducting the purchases only for the term required and on an appropriate scale; and (3) ensuring the Bank's financial health.

Based on these basic principles, the following actions could be taken for the time being. First, the Bank could begin outright purchases of CP and asset-backed CP (ABCP). It would be appropriate to draw up a scheme for such outright purchases in line with the basic principles and swiftly put it into action. And second, it would be appropriate to investigate ways to implement outright purchases of corporate bonds. In this case, it would be necessary to manage credit risk by, for example, restricting the purchases to corporate bonds with a residual maturity of up to one year.

V. Staff Proposal of Introduction of Outright Purchases of CP

In accordance with the decision made at the Monetary Policy Meeting held on December 18 and 19, 2008 to introduce outright purchases of CP, the staff would like to propose that the Bank take the necessary steps, such as establishment of Principal Terms and Conditions for Outright Purchases of CP.

VI. Staff Proposal of Acceptance of Debt Instruments Issued by Real Estate Investment Corporations as Eligible Collateral

To further facilitate the Bank's money market operations, improve the functioning of the real estate securitization market, and ensure stability in financial markets, the staff would like to propose that the Bank take the necessary steps, such as amendments to Guidelines on Eligible Collateral, to accept debt instruments issued by real estate investment corporations as eligible collateral for the Bank's provision of credit. The staff would also like to propose that the Bank take the necessary steps, such as an amendment to Principal Terms and Conditions for the Purchase of CP with Repurchase Agreements, to add CP issued by real estate investment corporations to the list of CP eligible to be purchased with repurchase agreements.

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

A. Economic Developments

With regard to <u>economic and financial conditions abroad</u>, members shared the view that, in a situation where global financial markets remained under increased strain, overseas economies had been slowing markedly. On this point, some members expressed the following view. First, the effects of financial crises in the United States and Europe had been spreading even to emerging economies, and the adverse feedback loop between financial and economic activity had been intensifying further on a global basis. And second, an inter-regional adverse feedback loop between trading partners -- a process whereby deceleration in domestic demand in any one country led to a decrease in its imports and a corresponding decrease in the exports of its trading partners -- was also operating worldwide, as suggested by the drop in the value of global trade.

Turning to the U.S. economy, members concurred that economic conditions had deteriorated significantly as the adverse feedback loop between financial and economic activity worsened amid the significant fall in the risk-taking capacity of financial institutions and investors. With regard to the housing market, many members expressed the view that there were no signs of bottoming out although mortgage rates were declining recently. One member pointed out the possibility that corporate balance sheets might be damaged eventually given that commercial real estate prices had recently fallen significantly. A few members added that business fixed investment had continued to decline due to weakening demand at home and abroad and financial institutions' tightening of lending standards. Some members noted that private consumption continued to decrease substantially, as seen in continued sluggish new car sales and in poor retail sales during the holiday season, against the background of deterioration in the employment and income situation and consumer confidence.

With regard to European economies, members shared the view that economic conditions in the euro area continued to deteriorate as exports particularly to Central and Eastern European countries had declined sharply, while domestic demand, especially private consumption and business fixed investment, had also decreased.

On Asian economies, members concurred that the economic slowdown had intensified, due to a decrease in exports reflecting the economic downturn in the United States and Europe and to deterioration in financial conditions mainly caused by a capital outflow. Some members focused on the Chinese economy in particular, and expressed the view that deceleration had become evident recently, especially in the developments in production and external trade. These members continued that, although domestic demand in China was likely to be pushed up by the large-scale economic stimulus package and a surge in bank lending resulting from the removal of the ceiling set on aggregate credit extended by commercial banks, it was necessary to continue to watch carefully to ascertain when and to what extent the effects on domestic demand appeared.

Based on the above discussion on economic and financial conditions abroad, members discussed <u>the state of Japan's economy</u>. They shared the view that economic conditions had deteriorated significantly and were likely to continue deteriorating for the time being given the following factors: exports had been decreasing substantially reflecting the slowdown in overseas economies; domestic demand had become weaker against the background of declining corporate profits and the worsening employment and income situation in the household sector; and financial conditions had become tighter. Some members said that Japan was experiencing a sharp economic deterioration equivalent to or even worse than that in the United States and Europe, and this was because, over the past several years, Japan's economy had established a growth mechanism that depended on continued expansion in global demand particularly for durable consumer goods, such as automobiles, and for capital goods. These members then expressed the view that an unprecedented drop in exports due to the overseas economic downturn had depressed production rapidly and substantially. A few members, referring to the especially severe economic downturn in the Osaka and Nagoya areas reported at the meeting of general managers of the Bank's branches held on January 16, 2009, said that this reflected the fact that manufacturers, particularly those producing goods for export, were being negatively affected and it was necessary to pay attention to the possible effects on small and medium-sized firms that did business with them.

As for the outlook, many members expressed the following view: for Japan's economy to start recovering, it was necessary that global financial markets regain stability and overseas economies move out of their deceleration phase, and the economy was likely to start recovering, at the earliest, from the latter half of fiscal 2009. In relation to this, some members said that the mechanism for economic recovery on a global basis was expected to operate through the synergy of the following processes. First, large-scale fiscal and monetary policy measures as well as various measures to stabilize the financial system taken in individual countries worldwide were expected to take effect. And second, adjustments of various imbalances accumulated in the past several years, which were the precondition for policy effects to appear, had been gradually progressing in the private sector, for example, in the areas of manufacturing and housing. A few members, however, were of the view that it would be some time before the effects of the measures taken in individual countries would be seen clearly, and that it was very uncertain how great they would be. Some members said that, given that adjustments of various imbalances accumulated in the past several years lay behind the current global economic downturn, it should be borne in mind that the global economy would require time to recover.

On the mechanism of Japan's economic growth in relation to the global economy, one member commented that attention should be paid to whether the established growth mechanism, which was primarily based on production for export of durable consumer goods and capital goods, required structural changes. A different member said that firms, particularly exporting firms, were expected to curtail excessive capacity, and the potential growth rate of Japan's economy might have declined to 1.0-1.5 percent or around 1.5 percent.

With regard to developments in each demand component, members concurred that exports had decreased substantially, and were likely to continue decreasing for the time being. Some members said that exports to China, which previously were relatively steady, had decreased substantially, and therefore developments warranted careful monitoring. One member noted that the decrease in exports to emerging economies might be an effect not only of the decrease in local demand but also a financial factor, the fact that local importers were facing difficulty in obtaining trade credit.

Many members expressed the view that business fixed investment was likely to continue declining significantly for the time being, mainly due to the slowdown in overseas economies, the decrease in corporate profits, and the deterioration in firms' funding conditions. Some members said that the recent large drop in machinery orders suggested a future significant decrease in business fixed investment, and future developments, including the risk that growth expectations of firms might weaken considerably, required close attention.

Some members said that private consumption had weakened as the employment and income situation had become increasingly severe, and was likely to continue weakening. One member noted that recent developments in stock prices and media reports about employment uncertainty seemed to have contributed to the further deterioration in consumer sentiment. Some members said that adjustments in employment, in terms of both wages and the number of employees, might spread from manufacturers to nonmanufacturing firms, and therefore developments warranted careful monitoring.

Many members expressed the view that production had decreased at a much faster pace, and was likely to continue to decrease for the time being since the weakness in domestic and external demand had become more evident. One member noted that the effects of sluggish production of processing industries such as the automobile industry were spreading to a wide range of materials industries such as the iron and steel and chemical industries in the form of production adjustments. Some members said that, although individual firms were cutting production significantly, there was the risk that a faster-than-expected decrease in global demand might exceed the pace of reduction in production, leading to protracted adjustments.

As for prices, members agreed that the year-on-year rate of increase in the CPI (excluding fresh food) had moderated recently, due to the declines in the prices of petroleum products and the stabilization of food prices, and was likely to become negative by the spring for the same reasons and due also to increasing slackness in supply and demand conditions in the overall economy. Some members added that, given the risk of a further decline in the inflation rate, it was important to closely monitor developments in medium- to long-term inflation expectations. One member expressed the view that, although downside risks to the outlook for prices required watching for the time being, from a longer perspective it was also necessary to always be aware of the possibility that a protracted worldwide monetary easing might cause various new excesses and in turn a recurrence of rising inflationary pressures.

B. Financial Developments

Members concurred that financial conditions in Japan had become tighter on the whole. A few members said that bank lending rates and interest rates on CP, particularly with high ratings, had recently declined slightly against the background of various policy measures, including the reductions in the policy interest rate. Some members, however, expressed the view that the effects of the reductions in the policy interest rate might not yet have been fully felt, as indicated by, for example, the fact that interbank rates on term instruments had remained at high levels and credit spreads on CP and corporate bonds had remained wide on the whole. Some members commented that firms continued to suffer from difficult funding conditions, especially limited availability of funds, as shown by the fact that (1) the amount outstanding of CP and corporate bonds issued had been below the previous year's level, as investors had continued to be selective in their purchases of them, and (2) an increasing number of firms had reported that their financial positions were weak and lending attitudes of financial institutions were severe. Many members said that corporate financing conditions required closer attention, given, for example, the fact that firms' cash flow from operating activities was decreasing sharply due to the significant decrease in production and sales since autumn 2008.

C. Interim Assessment

Given the above assessment of economic activity, prices, and financial developments, members agreed that prospects for Japan's economic growth rate and inflation rate had shifted downward compared with the projections presented in the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) released in October 2008. Most members expressed the view that the growth rate was likely to be negative in fiscal 2008 and fiscal 2009 and to recover to 1.0-2.0 percent in fiscal 2010. As for prices, most members were of the view that the year-on-year rate of change in both the CGPI and the CPI (excluding fresh food) was likely to be negative in fiscal 2009, and the rate of decline was likely to be somewhat less in fiscal 2010. Based on this discussion, members agreed that, although this scenario offered the prospect of the economy returning to a sustainable growth path with price stability in the latter half of the projection period, uncertainty remained high.

With regard to risk factors for the economy, members concurred that, in addition to global financial conditions and developments in overseas economies, both of which had been noted as risk factors in the October 2008 Outlook Report, the risk that firms' medium- to long-term growth expectations might decline and the adverse feedback loop between financial and economic activity might intensify warranted attention. As for prices, many members said that a possible decline in the medium- to long-term inflation expectations of firms and households required careful monitoring as an additional risk factor.

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

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that it would be appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to be at around 0.1 percent. This was because the Bank's recent policy rate reductions had been producing some positive effects, especially on the money market, and the Bank should continue to monitor the effects carefully.

On this basis, some members said that as the overnight interest rate had declined to the current extremely low level, it was important to work upon longer-term interest rates, which firms paid when they borrowed, that is, interest rates on term instruments. A few members expressed the view that the Bank should continue to examine what additional measures it could take to work upon these interest rates in its market operations. In relation to this, a different member said that one reason for the elevated interest rates on term instruments was the fact that it had become difficult for financial institutions to take on further credit risk due to capital constraints, and it was therefore important to increase capital at financial institutions.

Members next examined the basic principles regarding additional measures to facilitate corporate financing. They generally agreed with the staff's report on the basic principles, and said that it would be appropriate to draw up and make public the Bank's principles regarding outright purchases of corporate financing instruments. They then went further into points they considered especially important.

Some members said that, with outright purchases of corporate financing instruments, the Bank would come close to the realm of fiscal policy, because losses that would ultimately be borne by the taxpayer were more likely to occur than in the case of other policy tools and also because such purchases would deepen the involvement of the Bank in microeconomic resource allocation among individual firms. They continued that it was therefore important for the Bank to make clear that outright purchases of corporate financing instruments were an exceptional measure for a central bank. One member said that it should be borne in mind that outright purchases of various corporate financing instruments beyond what was necessary might in fact impair market functioning in Japan, the decline in which was limited so far in both degree and extent compared with that in other countries, notably the United States. Many members said that the decision to conduct outright purchases of such instruments should be made based not on the state of each market but on whether a decline in the functioning of a market was leading to tight overall corporate financing conditions. Based on this understanding, most members agreed that the following points should be ensured when implementing outright purchases of corporate financing instruments: (1) the Bank should prevent the purchases from constituting an arbitrary allocation of funds to particular firms; (2) the Bank should conduct such purchases on an appropriate scale in order to avoid a further decline in market functioning and adopt a purchasing scheme that would facilitate, when it became necessary, the smooth termination of such purchases as market functioning recovered; and (3) with a view to minimizing possible losses that would ultimately be borne by the taxpayer, the Bank should manage credit risk appropriately, by carefully determining how it would buy what kind of corporate financing instruments. Some members said that it was important, in addition to appropriately managing credit risk, to ensure the Bank's financial health through the appropriate disposal of losses and maintenance of adequate capital in the settlement of the Bank's accounts. These members continued that the Bank should seek the government's understanding of the principles discussed above.

Based on the basic principles regarding outright purchases of corporate financing instruments, members exchanged views on additional measures in the area of corporate financing.

Members discussed details concerning outright purchases of CP, which the Bank had decided to introduce at the previous Monetary Policy Meeting held on December 18 and 19, 2008. Many members were of the view that the Bank should also purchase ABCP with a view to facilitating financing of firms, including small ones, given that (1) issuing conditions in the ABCP market had tightened due to a decline in the functioning of the market and (2) most of the underlying assets of ABCP were firms' receivables and bills receivable. Based on this view, many members said that the Bank should (1) announce clearly that it would conduct outright purchases of such instruments only up until the fiscal year-end, (2) set certain conditions for financial instruments to be purchased in terms of their ratings and residual maturities and also set a limit on the amount of purchases from a single issuer in order to appropriately manage credit risk, and (3) set interest rates for purchasing such instruments at a level that would facilitate the smooth termination of purchases by causing the incentive to sell the instruments to the Bank to diminish as market functioning recovered. Regarding the total outstanding amount of such purchases by the Bank, members agreed that the upper limit should be 3 trillion yen taking account of the following points: (1) the Bank would purchase not only CP but also ABCP; (2) CP could be issued by firms to raise funds in order to meet higher demand toward the fiscal year-end arising, for example, from redemptions of corporate bonds; and (3) excessive intervention by the Bank in markets should be avoided.

Members next discussed points concerning possible outright purchases of corporate bonds. Many members were of the view that these should also be examined further, given that the functioning of the corporate bond market had declined significantly, as indicated by a marked expansion of credit spreads and the fact that only a limited number of firms were able to issue bonds, and the decline in the functioning of the corporate bond market was one of the factors behind the tight corporate financing conditions. Some members added that purchases should be limited to corporate bonds with a residual maturity of up to one year, since a central bank's primary function was provision of liquidity and appropriate management of credit risk was necessary. In contrast to these views, one member expressed the opinion that it was premature to make a decision to conduct outright purchases of corporate bonds at this point and, for the time being, the Bank should continue to examine market conditions as well as the degree of tightness in corporate financing conditions for the following reasons: (1) the recent decline in the functioning of the corporate bond market had not led to overall tightness in corporate financing, due partly to firms obtaining alternative funding through issuance of CP and borrowing from banks; and (2) outright purchases of corporate bonds with a residual maturity of up to one year could only be expected to have a limited effect as a means of facilitating corporate financing. The member added that it was also inappropriate even to make public a decision to examine outright purchases of corporate bonds at present, given the possible impact on the market. In relation to this opinion, a different member expressed the view that outright purchases of corporate bonds even with a residual maturity of up to one year would be able to contribute to facilitating corporate financing through various channels, for example, via the support they would give to a recovery in market functioning by encouraging securities companies to underwrite corporate bonds and via the boost they would give to financial institutions' capacity to extend loans.

Members then discussed the possible acceptance of debt instruments issued by real estate investment corporations as eligible collateral for the Bank's provision of credit. They agreed that it was appropriate to accept bonds and CP issued by real estate investment corporations, bills drawn by them, and loans on deeds to them as eligible collateral for the Bank's provision of credit, with a view to further facilitating the Bank's money market operations, improving the functioning of the real estate securitization market, and ensuring stability in financial markets. Furthermore, they concurred that the Bank should add CP issued by real estate investment corporations to the list of CP eligible to be purchased with repurchase agreements. One member commented that acceptance of debt instruments issued by real estate investment corporations as eligible collateral was consistent with the Bank's past decision to accept asset-backed securities (ABSs) and ABCP with a view to promoting the development of markets for securitized products. A different member said that, given that debt instruments issued by real estate investment corporations were intermediate in character between corporate bonds and ABSs, appropriate eligibility criteria should be applied.

IX. Remarks by Government Representatives

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

(1) The Bank seemed to assess Japan's economic conditions as very severe, and this assessment was reflected in, for example, the projection of a negative rate of change in the CPI.

(2) The government would like the Bank to continue to conduct monetary policy in an appropriate and flexible manner so as to support the economy from the financial side, based on the Bank's experience of taking various measures in dealing with the post-bubble deflation.

(3) The government welcomed the Bank's policy actions such as the introduction of outright purchases of CP, as they were likely to facilitate corporate financing in a situation where there was the risk of a further increase in the severity of financial conditions during the run-up to the fiscal year-end. The government hoped for early introduction of other measures to facilitate corporate financing that were under consideration.

(4) In relation to outright purchases of corporate financing instruments, the need to ensure the Bank's financial health had been discussed at this meeting. The government would give due consideration to the fact that the Bank regarded taking on credit risk as a serious matter. If such credit risk materialized, the Ministry of Finance would respond in full consultation with the Bank, on the occasion of discussing the settlement of the Bank's accounts.

The representative from the Cabinet Office made the following remarks.

(1) Japan's economy had worsened rapidly. Looking ahead, it was likely to continue worsening for the time being, and attention should be given to risk factors that might make economic conditions more severe such as the worsening global financial crisis and the possibility of a further slowdown in overseas economies.

(2) The government submitted the second supplementary budget for fiscal 2008 and the budget for fiscal 2009 to the Diet with a view to implementing economic measures as the top priority in the near term. The government would pursue sound public finance based on "Medium- to Long-Term Fiscal Policy and Economic and Fiscal Outlook for Next Ten Years," but it would also take prompt and bold action flexibly in response to changes in global economic and financial conditions.

(3) Given the recent severe economic and financial conditions at home and abroad, the government would like to request the Bank to support the economy by conducting monetary policy in an appropriate and flexible manner, taking account of the government's policy efforts and the Bank's interim assessment at this meeting of the October 2008 Outlook Report, and sharing the basic perspective on macroeconomic management with the government.

(4) The government considered that outright purchases of CP by the Bank were an appropriate response to a situation where firms' financial positions were weakening. The government would like the Bank to closely examine developments in corporate financing and to appropriately implement measures to facilitate it so that firms could secure sufficient funds during the run-up to the fiscal year-end.

X. Votes

A. Vote on the Guideline for Money Market Operations

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

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

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

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

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

2. A public statement will be decided separately.

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

B. Vote on Outright Purchases of Corporate Financing Instruments

To reflect the view of members, the chairman formulated a policy proposal on outright purchases of corporate financing instruments and put it to the vote. The chairman's policy proposal was approved by a majority vote. It was confirmed that the statement Outright Purchases of Corporate Financing Instruments would be released immediately after the meeting (see Attachment 1).

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

Ms. M. Suda dissented from the above proposal for the following reason. Recent overall conditions for corporate financing were not so severe as to require the Bank to conduct outright purchases of corporate bonds. In view of this and the possible impact on the market, it was premature at this point to decide to examine outright purchases of corporate bonds and make this decision public in the statement.

C. Vote on Establishment of Principal Terms and Conditions for Outright Purchases of CP

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

D. Vote on Amendments to Guidelines on Eligible Collateral

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

XI. Discussion on the Statement on Monetary Policy

Members discussed the Statement on Monetary Policy, and put it to the vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment 3).

XII. Approval of the Minutes of the Monetary Policy Meetings

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of December 2, 2008 and December 18 and 19 for release on January 27, 2009.

XIII. Approval of Changes in the Scheduled Dates Related to the Monetary Policy Meetings in January-December 2009

The Policy Board approved changes in the dates related to the Monetary Policy Meetings in the period January-December 2009 for immediate release (see Attachment 5).

Attachment 1

January 22, 2009

Bank of Japan

Outright Purchases of Corporate Financing Instruments[NOTE]

The Bank of Japan examined additional measures in the area of corporate financing including outright purchases of CP, and has established the following basic principles regarding the outright purchases of corporate financing instruments to facilitate corporate financing.

Based on these principles, the Bank decided to begin, from this month, outright purchases of CP and ABCP based on the scheme outlined in Attachment 2. In addition, the Chairman instructed Bank staff to investigate ways to implement outright purchases of corporate bonds with a residual maturity of up to 1 year and swiftly map out a concrete plan.

1. Distinctive features in the outright purchases of corporate financing instruments

- The degree of taking on the credit risks of individual private firms is greater in the case of outright purchases of corporate financing instruments than when these instruments are taken as collateral for providing credit to financial institutions. Therefore, outright purchases involve a relatively higher probability of imposing costs on taxpayers by incurring losses, and deepen the involvement of the Bank in microeconomic resource allocation among individual firms.

- In addition, outright purchases involve higher risks, compared to other policy measures, of damaging the financial health of the Bank by incurring losses and

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

ultimately undermining confidence in the currency and monetary policy.

- Given these considerations, outright purchases of corporate financing instruments should be regarded as an exceptional measure for a central bank, and their implementation as well as ways to implement them should be examined accordingly.

2. Necessary conditions for the implementation

- Outright purchases of corporate financing instruments with a view to facilitating corporate financing should be implemented only when the following conditions are met.

  a) A significant decline in market functioning of corporate financing instruments is observed in, for example, a significant rise in interest rates regardless of issuing firm's conditions or in fewer transactions, leading to tight corporate financing conditions on the whole.

  b) The Bank's outright purchases of corporate financing instruments as an exceptional measure, taking full account of the factors below, are judged necessary to improve the situation in light of the Bank's mission.

3. Factors to be considered in the implementation

(1) Preventing the purchases from functioning as arbitrary funds allocation among individual firms

- In order to prevent the purchases from functioning as arbitrary funds allocation among individual firms, the Bank will adopt an appropriate purchasing scheme that may include conditions such as (1) purchasing from financial institutions that are counterparties of the Bank instead of purchasing directly from issuers and (2) purchasing by means of competitive auctions.

(2) Conducting the purchases only for a term required and in an appropriate scale

- The Bank will set either the date of the termination or the conditions for the termination to ensure that purchases are conducted only for a term required.
- The Bank will conduct purchases in an appropriate scale in order to avoid a further decline in market functioning due to excessive reliance on the Bank's purchases.
- The Bank will adopt a purchasing scheme that will ensure purchases in an appropriate scale and facilitate, when necessary, the smooth termination of purchases by, for example, structuring the scheme in a way that the incentive to sell the instrument to the Bank becomes smaller as the market recovers its functioning.

(3) Ensuring the Bank's financial health

- Given the higher risk of incurring losses compared to other monetary policy measures, the Bank will properly manage credit risks arising from outright purchases. Accordingly, the Bank will set certain conditions on financial instruments to be purchased in terms of their creditworthiness and residual maturities. The Bank will also set a limit on the total amount of purchases and take measures to avoid concentration of credit risks in a specific firm.
- In addition to the appropriate management of credit risks, the Bank will ensure its financial health through appropriate disposal of losses and maintenance of adequate capital in the process of settling Bank's account. The Bank will seek the government's understandings for these principles.

Attachment 2

Outline of Outright Purchases of CP

1. CP to be Purchased

CP and ABCP that are eligible as the Bank's collateral, a-1 rated, issued before or on the auction date and with the residual maturity of up to 3 months.

2. Eligible Counterparties

Financial institutions that wish to be counterparties of this operation among those who are already counterparties in the Bank's CP repo operations or those who are to borrow funds at the Bank's Head Office in the Bank's Funds-Supplying Operations against Pooled Collateral.

3. Method for Auctions

A multiple-price competitive auction in which a minimum yield equally applied to CP and ABCP is set according to their residual maturity as below and counterparties bid the non-negative yield spread from the minimum yield. Minimum yields are subject to change.

(A residual maturity of up to 1 month)

The targeted uncollateralized overnight call rate plus 20 bps

(A residual maturity of more than 1 month and up to 3 months)

The targeted uncollateralized overnight call rate plus 30 bps

4. Amount to be Purchased

The outstanding amount of CP (including ABCP) purchased by the Bank shall not exceed 3 trillion yen.

The outstanding amount of a single issuer's CP (including ABCP) purchased by the Bank shall not exceed 100 billion yen. In addition, if the outstanding amount of a single issuer's CP purchased by the Bank exceeds 25 percent of the "upper limit" (the highest end-of-the-month figure for the CP issued by an issuer between July 2008 and December 2008), the CP would be excluded from the eligible list of CP until the outstanding amount of the issuer's CP purchased by the Bank falls below the upper limit by redemptions.

5. Duration of Purchases

All outright purchases of CP will be conducted by March 31, 2009.

6. Schedule, etc.

10 purchases are scheduled and they will be offered on January 30, February 4, 10, 16, 20 and 25 and March 2, 6, 11 and 16. The schedule is subject to change.

The amount of each purchase is planned to be 300 billion yen.

Attachment 3

January 22, 2009

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

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

2. Exports have been decreasing substantially reflecting a slowdown in overseas economies, and domestic demand has become weaker against the background of declining corporate profits and the worsening employment and income situation in the household sector. Financial conditions have become tighter. Under these circumstances, economic conditions have been deteriorating significantly and are likely to continue deteriorating for the time being. Meanwhile, CPI inflation (excluding fresh food) has recently moderated reflecting the declines in the prices of petroleum products and the stabilization of food prices, and will likely become negative by this spring with increasing slackness in supply and demand conditions. The Bank's baseline scenario through fiscal 2010 expects that, with the assumption of medium- to long-term growth expectations and inflation expectations remaining generally unchanged, the economy will, from the latter half of fiscal 2009, start recovering and price declines will abate as global financial markets regain stability and

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

overseas economies move out of their deceleration phase. Although this scenario offers prospects for the economy to return to a sustainable growth path with price stability in the latter half of the projection period, uncertainty is high.

3. Compared with the projections presented in the October 2008 *Outlook for Economic Activity and Prices*, growth prospects for fiscal 2008 and fiscal 2009 have shifted significantly downward and the growth rates are expected to be negative. In fiscal 2010, the growth rate is projected to recover to around 1.5 percent. Turning to prices, the year-on-year rates of change in domestic corporate goods prices are expected to be lower, notably for fiscal 2009, than the October projection. The year-on-year rates of change in consumer prices (excluding fresh food) are also expected to be lower than the October projection; recording a decline of around 1 percent in fiscal 2009 and somewhat less in fiscal 2010.

4. With regard to risk factors, much depends on global financial conditions as well as developments in overseas economies, and attention will need to be paid to the downside risks posed to economic activity. In addition, there is a risk of a further weakening in domestic private demand through a decline in firms' medium- to long-term growth expectations, raising pressures for adjusting capital stock and employment. If financial conditions should tighten further, pressures acting to depress economic activity from the financial side may become more marked and an adverse feedback loop between financial and economic activities may intensify. Turning to prices, there is a possibility that the inflation rate will decline further if downside risks to economic activity materialize or commodity prices fall. In this case, the risk of a decline in medium- to long-term inflation expectations of firms and households warrants attention.

5. Since last fall, the Bank, in addition to reductions in the policy interest rates, has been conducting various measures to support Japan's economy from the financial side such as the substantial provision of liquidity and implementation of measures to facilitate corporate financing. Today, the Bank, among other policy decisions, outlined its principles regarding outright purchases of corporate financing instruments, and decided

on the specifics of outright purchases of CP as well as agreed to examine outright purchases of corporate bonds (see Attachment 4). The Bank will continue to carefully assess the future outlook for economic activity and prices, closely considering the likelihood of its projections as well as risk factors, and to exert its utmost efforts as a central bank to facilitate the return of Japan's economy to a sustainable growth path with price stability.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2008	-2.0 to -1.7 [-1.8]	+3.0 to +3.2 [+3.1]	+1.1 to +1.2 [+1.2]
Forecasts made in October 2008	+0.1 to +0.2 [+0.1]	+4.3 to +4.8 [+4.6]	+1.5 to +1.6 [+1.6]
Fiscal 2009	-2.5 to -1.9 [-2.0]	-7.0 to -6.0 [-6.4]	-1.2 to -0.9 [-1.1]
Forecasts made in October 2008	+0.3 to +0.7 [+0.6]	-1.4 to -0.4 [-0.8]	-0.2 to +0.2 [0.0]
Fiscal 2010	+1.3 to +1.8 [+1.5]	-1.5 to -0.8 [-0.9]	-0.6 to 0.0 [-0.4]
Forecasts made in October 2008	+1.5 to +1.9 [+1.7]	-0.3 to +0.5 [+0.3]	+0.1 to +0.5 [+0.3]

Notes: 1. Figures in brackets indicate forecast medians.

2. The forecasts of the majority of Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate, namely the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest and lowest figures excluded. It should be noted that the range does not indicate the forecast errors.

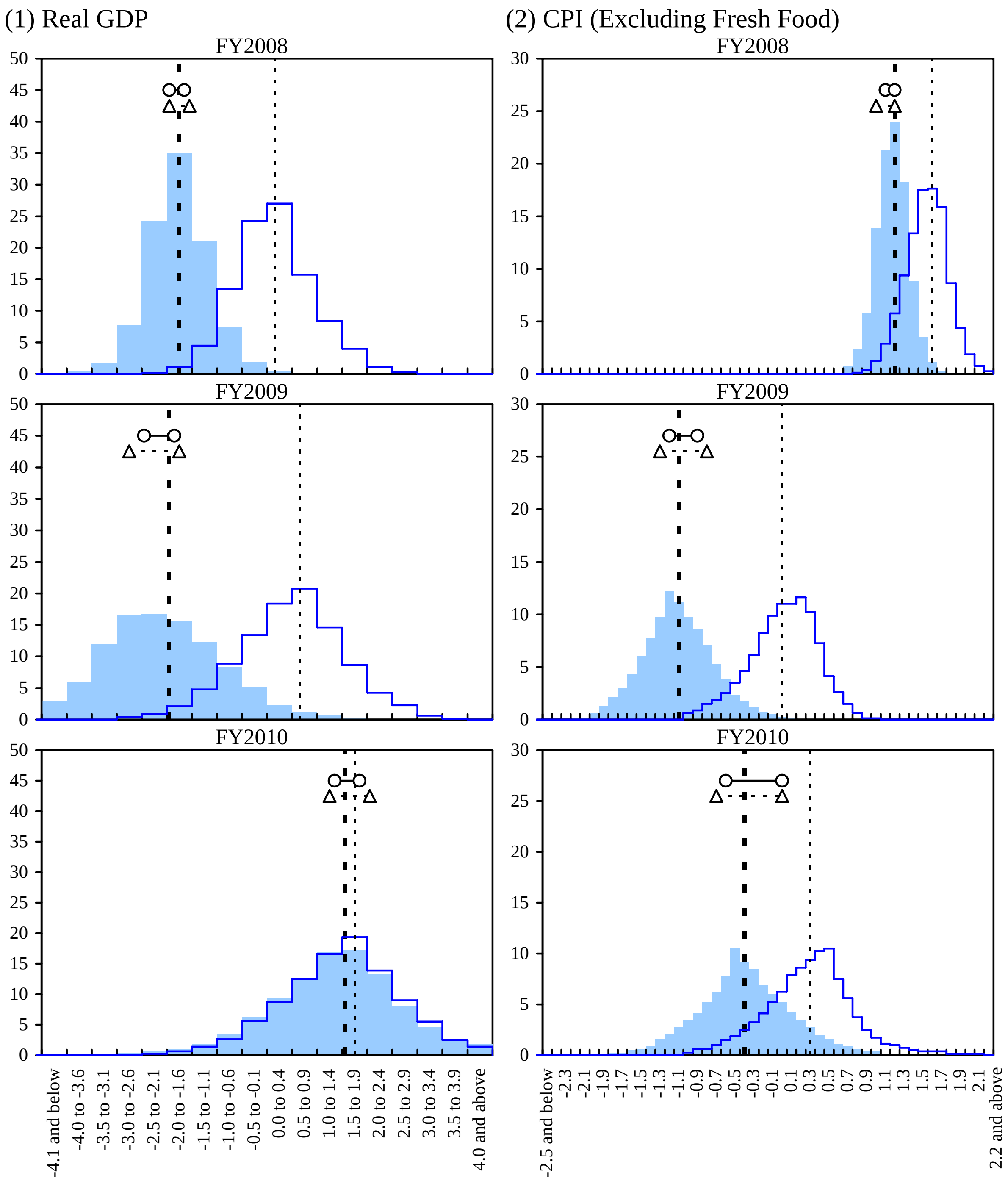
3. Individual Policy Board members make the above forecasts with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates.

4. The forecasts of all Policy Board members may be summarized as follows.

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2008	-2.0 to -1.6	+2.8 to +3.2	+1.0 to +1.2
Forecasts made in October 2008	-0.4 to +0.3	+4.0 to +4.8	+1.5 to +1.7
Fiscal 2009	-2.8 to -1.8	-7.0 to -5.0	-1.3 to -0.8
Forecasts made in October 2008	+0.3 to +0.8	-1.5 to -0.2	-0.3 to +0.3
Fiscal 2010	+1.2 to +2.0	-1.8 to -0.5	-0.7 to 0.0
Forecasts made in October 2008	+1.3 to +2.0	-0.3 to +0.6	-0.1 to +0.5

Risk Balance Charts



Notes: 1. Vertical axes in the charts represent probability (%), while horizontal axes represent the year-on-year percentage changes in the respective indicators. Bar charts represent the probability distributions in January 2009, and solid lines represent those in October 2008.

2. Vertical dashed heavy lines indicate the median of the Policy Board members' forecasts (point estimates). ○——○ indicates the range of the forecasts of the majority of Policy Board members. △- - -△ indicates the range of the forecasts of all Policy Board members.

3. Vertical dashed thin lines indicate the median of the Policy Board members' forecasts (point estimates) in October 2008.

4. For the process of compilation of the Risk Balance Charts, see the box on page 9 of the April 2008 *Outlook for Economic Activity and Prices*.

Attachment 4

Policy Decisions

1. Basic principles regarding outright purchases of corporate financing instruments (see Document 1)
2. Outright purchases of CP (see documents 1 and 2)
3. Examination of outright purchases of corporate bonds with a residual maturity of up to one year (see Document 1)
4. Acceptance of debt instruments issued by real estate investment corporations as eligible collateral (see Document 3)
5. Expansion in the range of Japanese government bonds accepted in outright purchases and introduction of purchases from specific brackets classified by bond type and residual maturity (see documents 4 and 5)

Document 1: Outright Purchases of Corporate Financing Instruments

Document 2: Establishment of "Principal Terms and Conditions for Outright Purchases of CP"

Document 3: Amendments to "Guidelines on Eligible Collateral"

Document 4: Outline of Outright Purchases of Japanese Government Bonds

Document 5: Amendments to "Principal Terms and Conditions for the Outright Purchase/Sale of Japanese Government Bonds"

Attachment 5

January 22, 2009

Bank of Japan

Scheduled Dates of Monetary Policy Meetings in January-December 2009

Revised

Dates underlined are revised dates (those crossed-out are previously released on December 19, 2008).

	Date of MPM	Publication of MPM Minutes	Publication of Outlook Report (The Bank's View)	(Reference) Publication of Monthly Report
Jan. 2009	21 (Wed.), 22 (Thur.)	Feb. 24 (Tue.)	--	23 (Fri.)
Feb.	18 (Wed.), 19 (Thur.)	Mar. 24 (Tue.) ~~Mar. 23 (Mon.)~~	--	20 (Fri.)
Mar.	17 (Tue.), 18 (Wed.) ~~16 (Mon.), 17 (Tue.)~~	Apr. 10 (Fri.)	--	19 (Thur.) ~~18 (Wed.)~~
Apr.	6 (Mon.), 7 (Tue.)	May 8 (Fri.)	--	8 (Wed.)
	30 (Thur.)	May 27 (Wed.)	30 (Thur.)	--
May	21 (Thur.), 22 (Fri.)	June 19 (Fri.)	--	25 (Mon.)
June	15 (Mon.), 16 (Tue.)	July 21 (Tue.)	--	17 (Wed.)
July	14 (Tue.), 15 (Wed.)	Aug. 14 (Fri.)	--	16 (Thur.)
Aug.	10 (Mon.), 11 (Tue.)	Sep. 25 (Fri.)	--	12 (Wed.)
Sep.	16 (Wed.), 17 (Thur.)	Oct. 19 (Mon.)	--	18 (Fri.)
Oct.	13 (Tue.), 14 (Wed.)	Nov. 5 (Thur.)	--	15 (Thur.)
	30 (Fri.)	Nov. 26 (Thur.)	30 (Fri.)	--
Nov.	19 (Thur.), 20 (Fri.)	Dec. 24 (Thur.)	--	24 (Tue.)
Dec.	17 (Thur.), 18 (Fri.)	To be announced	--	21 (Mon.)

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

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

Outlook for Economic Activity and Prices (Outlook Report):

"The Bank's View" in the Outlook Report will be released at 3:00 p.m., and the full text at 2:00 p.m. on the next business day.

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

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