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August 13, 2010

Bank of Japan

Minutes of the Monetary Policy Meeting

on July 14 and 15, 2010

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

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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, July 14, 2010, from 2:00 p.m. to 4:39 p.m., and on Thursday, July 15, from 9:02 a.m. to 12:40 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. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Government Representatives Present

Mr. M. Ikeda, Senior Vice Minister of Finance, Ministry of Finance[2]

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

Mr. K. Tsumura, Parliamentary Vice-Minister, Cabinet Office[2]

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

Reporting Staff

Mr. K. Ido, Executive Director

Mr. K. Yamamoto, Executive Director

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

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on August 9 and 10, 2010 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. M. Ikeda and K. Tsumura were present on July 15.

[3] Messrs. S. Kagawa and K. Umetani were present on July 14.

Mr. M. Amamiya, Executive Director

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

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

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

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

Mr. T. Sekine, Associate Director-General, Research and Statistics Department

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

Secretariat of the Monetary Policy Meeting

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

Mr. T. Tachibana, Director, Deputy Head of Secretarial Services for the Board, Secretariat of the Policy Board

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

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

I. Summary of Staff Reports on Economic and Financial Developments[4]

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 June 14 and 15, 2010.[5] The uncollateralized overnight call rate had been at around 0.1 percent.

The Bank continued its provision of funds through the fixed-rate funds-supplying operation against pooled collateral, and in consideration of the recent formation of market rates, conducted money market operations in a flexible manner. On July 13, the Bank conducted an auction for the U.S. dollar funds-supplying operation, but the value of bids was small.

B. Recent Developments in Financial Markets

Money market rates had generally been stable at low levels due to the Bank's provision of ample funds. General collateral (GC) repo rates had generally been in the range of 0.10-0.15 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with a one-year maturity, had been stable in the range of 0.10-0.15 percent, and the TIBOR rates had declined somewhat. Issuance rates on CP had remained more or less unchanged at low levels, and differences in these rates among various issuers had narrowed, albeit to a slight degree. European financial markets had continued to be unstable, but the effects on Japan's money market had remained limited.

Japanese stock prices had declined somewhat, reflecting weakness in U.S. and European stock prices until early July and the appreciating trend of the yen. The Nikkei 225 Stock Average had recently been at around 9,500 yen. Long-term interest rates in Japan had declined amid a decrease in long-term interest rates abroad reflecting, for example, cautious views on the pace of U.S. economic recovery. The benchmark rate had recently been in the range of 1.10-1.15 percent.

The yen had appreciated against the U.S. dollar and had recently been in the range of 88-89 yen.

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

[5] The guideline was as follows:

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

C. Overseas Economic and Financial Developments

The world economy had continued to recover moderately.

The U.S. economy was recovering at a moderate pace. Exports were increasing, private consumption was expanding at a moderate rate, and business fixed investment as a whole was picking up. Reflecting such developments in demand, production was recovering moderately. In the labor market, the number of employees was picking up, while the unemployment rate had been more or less unchanged at a high level. The numbers of housing starts and home sales remained at depressed levels, below market expectations. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less energy and food, or the core CPI, had been moderating against the backdrop of slack in supply and demand conditions and slower growth in wages.

Economic activity in the euro area was picking up, with some differences in growth by country. Exports had been firm partly due to the depreciation of the euro, and production in the manufacturing sector had been increasing gradually. Meanwhile, private consumption had been relatively weak, as moves toward fiscal consolidation across the area were exerting downward pressure on consumer confidence. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food had been declining moderately against the backdrop of slack in supply and demand conditions and slower growth in wages. The U.K. economic activity was picking up.

The Chinese economy had continued to grow at a relatively rapid pace, led mainly by domestic demand. Growth in private consumption had been firm mainly due to higher income levels, and fixed asset investment had been increasing, although at a slower pace. Exports had also been rising due to the recovery in overseas economies, and production had continued to increase. Economic conditions in the NIEs and the ASEAN countries were recovering steadily. Exports had continued to rise on the back of expanding demand for IT-related goods, and private consumption and business fixed investment had been on an increasing trend. Under these circumstances, production was increasing. The Indian economy had also continued to grow at a relatively rapid pace. In many of these Asian economies, upward pressure on prices had been increasing due to higher energy and food prices and greater utilization of production factors such as labor and capital.

As for global financial markets, sovereign risks in Europe had continued to be a concern. In the money market, participants had been cautious about counterparty risks in relation to European financial institutions, and upward pressure on interest rates on term instruments had continued. U.S. and European stock prices, which had tended to be volatile mainly due to the fiscal problem in Europe, had fluctuated sharply: they dropped significantly, as many U.S. economic indicators were worse than market expectations, and rose thereafter. Long-term interest rates in the United States had declined reflecting more cautious views on the outlook for the economy. Those in Germany had fallen mainly due to a flight to quality, while those in some other European countries had been at high levels on the back of concern about their fiscal problems.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had been increasing, due to the improvement in overseas economic conditions. Those to emerging economies in particular had been on a firm uptrend; expanding global demand for IT-related goods and other factors had recently led to rapid growth in exports of IT-related goods and of capital goods and parts, especially to East Asia. The uptrend in exports was expected to continue, reflecting continued improvement in overseas economic conditions, although the pace of increase was likely to moderate gradually.

Public investment was declining, and this trend was likely to continue.

With regard to domestic private demand, business fixed investment was showing signs of picking up. Although such signs were expected to gradually become evident with the continued improvement in corporate profits, the pace of improvement in business fixed investment was likely to remain moderate for the time being amid the persistent sense among firms of excessive capital stock.

Private consumption had been generally picking up. Meanwhile, the employment and income situation had remained severe, but the degree of severity had eased somewhat. Private consumption was expected to continue picking up, but the pace of improvement was likely to remain moderate for the time being, since the effects of policy measures were expected to wane.

Housing investment had leveled out. It was expected to gradually head for a recovery, given the recent developments in housing starts.

Production had been increasing. It was likely to continue rising as a trend in parallel with exports, although the pace of increase was expected to moderate gradually.

On the price front, commodity prices had been weakening slightly. The three-month rate of increase in the domestic corporate goods price index (CGPI) was slowing, mainly due to the decrease in commodity prices, amid the persistent slack in supply and demand conditions for products. The CGPI was expected to be somewhat weak for the time being, since the effects of the decrease in commodity prices were likely to continue. The CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline had continued. The year-on-year pace of decline in the CPI was likely to slow as a trend as the aggregate supply and demand balance improved gradually.

2. Financial environment

Financial conditions had continued to show signs of easing. The overnight call rate had remained at an extremely low level, and the declining trend in firms' funding costs had continued. While stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices, such effects were beginning to strengthen in light of improved corporate profits. With regard to credit supply, firms saw financial institutions' lending attitudes as improving. Issuing conditions for CP and corporate bonds had remained favorable as a whole. As for credit demand, firms' need to fund working capital and fixed investment had declined, and some firms had reduced the on-hand liquidity that they had accumulated. Against this backdrop, bank lending had declined on a year-on-year basis. The amount outstanding of corporate bonds had exceeded the previous year's level, while that of CP had declined. In these circumstances, firms' financial positions had continued to show signs of improvement as a whole. Meanwhile, the year-on-year rate of change in the money stock had been at around 3 percent.

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

A. Economic Developments

Many members expressed the view that <u>global financial markets</u> remained unstable, especially European markets. Some members said that the recent bidding of government bonds such as Spain's went relatively smoothly, and this suggested that the concern about sovereign risks in some European countries had eased somewhat. Many members, however, expressed the opinion that the situation still warranted attention because yield spreads between government bonds issued by Germany and those issued by other European countries, as well as spreads on U.S. and European corporate bonds, had been at relatively high levels on the back of the continued risk aversion among investors. Some members commented that there had been upward pressure in U.S. and European money markets on interest rates on term instruments because market participants had been cautious about counterparty risks in relation to European financial institutions. In this regard, many members referred to the stress test exercise being conducted on 91 European financial institutions -- the results of which would be released on July 23. One member raised the possibility that, if the stress test exercise dispelled uncertainty about financial institutions' financial soundness, this might lead to stabilization of financial markets. Some members added that another key issue was whether European countries could swiftly launch specific measures for stabilizing the financial system in view of the results of the stress test exercise.

Members shared the view that overseas economies had continued to recover moderately, and this trend was likely to continue led by higher growth in emerging economies. With regard to emerging economies, many members noted that their growth had continued to be somewhat faster than expected. Some members raised the following as factors behind the high growth: the continued increase in private consumption and infrastructure-related investment; and a large increase in Asian exports, reflecting the global expansion of the markets for new IT products, such as smartphones, observed in recent years. Many members said that emerging economies were likely to continue to grow at a relatively rapid pace with the virtuous circle of growth in production, income, and spending remaining intact. These members expressed the view that whether these economies could make a soft landing onto a sustainable growth path was extremely important in terms of bringing the world economy toward steady growth. Regarding advanced economies, many members said that they had continued to recover, albeit at a moderate pace. Some members, however, were of the opinion that the pace of recovery was likely to be only moderate, given the severe employment situation and governments' fiscal conditions.

A few members -- referring to the prevailing projection for the world economic growth rate in the coming years of above 4 percent, a rate similar to that observed during the years preceding the bursting of the credit bubble -- expressed some reservations about whether the world economy could continue to grow at such a rapid pace. One of these members said that the recent high growth was partly attributable to the fact that the extremely accommodative monetary policy in advanced countries had been indirectly stimulating economic activity in emerging countries, rather than directly stimulating economic activity in their own countries, and it was difficult to judge the sustainability of such a mechanism.

Members shared the view that the U.S. economy was recovering at a moderate pace and was likely to generally continue recovering. Some members said that exports and production continued to increase and that business fixed investment as a whole was picking up, as evidenced by the uptrend in new orders for capital goods. A few members said that private consumption was expanding at a moderate rate against the backdrop of an increase in working hours. On the other hand, some members expressed the opinion that, judging from the prolonged average duration of unemployment and the decline in stock prices, the environment surrounding consumption had not improved noticeably. A few members raised the possibility that the recent developments in stock prices and weak economic data, housing indicators in particular, might suggest a weakening of the momentum of U.S. economic recovery. Members shared the view that the U.S. economy as a whole was likely to continue recovering. One member added that the basic mechanism -- in which the effects of strong corporate performance spilling over to business fixed investment and wages, thereby underpinning economic activity -- was likely to continue operating. However, some members expressed the view that the pace of economic recovery would likely remain moderate for the time being, given that balance-sheet adjustment pressure had persisted in the household sector. One of these members saw risks as tilted to the downside. Based on this discussion, members said that due attention should be paid to future developments in the U.S. economy, some indicators of which had recently shown weakness.

Many members expressed the view that economic activity in the euro area overall was picking up mainly due to a steady increase in exports, with some differences in economic growth by country. Some members said that the employment situation remained severe -- as evidenced by the fact that the unemployment rate continued to be at a high level of around 10 percent -- and private consumption had been relatively weak. Some members were of the view that the euro area economy would likely continue to head toward a moderate recovery as the depreciation of the euro boosted exports. Some members, however, expressed the opinion that attention should be paid to the possibility that, depending on developments in fiscal tightening measures planned for implementation in euro area countries, economic activity in the area might be exposed to stronger-than-expected downward pressure. In this regard, one member mentioned a view that actions taken toward fiscal consolidation could ease the public's concern about the future and have an immediate positive impact on consumption. A few members expressed the view that, if the European financial system became unstable due to such factors as materialization of sovereign risks, the adverse feedback loop between financial and economic activity might intensify again.

Members agreed that the Chinese economy had continued to grow at a rapid pace against the background of high growth in domestic demand and a surge in exports. Many members said that the pace of economic growth was likely to slow somewhat mainly due to the effects of measures to restrain the increase in real estate transactions. Some members, however, expressed the view that the Chinese economy was unlikely to decelerate rapidly in the near future, taking account of the following factors specific to China: high economic growth was required to create sufficient employment opportunities; and the government's measures to restrain excessive economic activity targeted only some markets that had shown notable signs of overheating, such as the real estate market. With regard to the effects on the Chinese economy of the renminbi exchange rate's enhanced flexibility, which was announced by the People's Bank of China in June, a few members said that these had been marginal because there had been only a slight appreciation of the renminbi against the U.S. dollar to date. A few members were of the opinion that the risk of inflation had increased in China, as evidenced by the acceleration in the CPI inflation rate and the rise in wages across the country on the back of increased labor disputes. Based on this discussion, some members said that full attention should continue to be paid to the future conduct of China's macroeconomic policy and its effects.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. They concurred that the economy showed further signs of a moderate recovery, induced by improvement in overseas economic conditions. Some members expressed the view that improvement was spreading in the corporate sector on the back of an increase in exports and production, and this improvement was beginning to spill over to the household sector, albeit at a moderate pace. One member, referring to the results of the June 2010 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), said that business confidence had improved significantly not only in manufacturing industries but also in nonmanufacturing industries such as transport and information services. Some members said that private consumption had been generally picking up in reflection of improved corporate profits and reduced employment uncertainty, and indicators of consumer confidence had been on a recovery trend on the whole. Meanwhile, some members noted the recent slowing of growth in industrial production and signs of weakness in some other indicators such as machinery orders and the unemployment rate. In relation to this, a few members expressed the view that Japan's economy, since bottoming out in spring 2009, had been recovering at a faster pace than U.S. and European economies, and therefore it was inevitable that the pace of recovery would slow to some extent as the effects of inventory restocking and policy measures waned.

As for the outlook, members concurred that Japan's economy was likely to recover at a moderate pace. Some members expressed the view that, although policy effects were likely to wane in the latter half of fiscal 2010, self-sustaining recovery in domestic private demand was likely to gain momentum led by a recovery in corporate activity and consequent gradual improvement in the employment and income situation.

Turning to developments in each demand component, members shared the view that <u>exports</u> had been increasing more steadily than they had previously expected, mainly due to high growth in emerging economies and the expansion in global demand for IT-related goods. Many members agreed that the uptrend in exports was likely to continue, reflecting continued improvement in overseas economic conditions. In relation to this, a few members expressed the view that growth in Japan's exports was likely to gradually slow toward a more sustainable pace, as the effects of inventory restocking would wane, especially in Asia.

Members agreed that <u>business fixed investment</u> was showing signs of picking up. Many members expressed the view that signs of a pick-up were likely to gradually become evident with the continued improvement in corporate profits. Some members said that, in the June 2010 *Tankan*, fixed investment plans of manufacturing and nonmanufacturing firms for fiscal 2010 were revised upward and the aggregated amount of all industries' plans exceeded the previous year's level for the first time in three years. However, some members were of the opinion that manufacturers in particular had revised their investment plans only slightly relative to the increase in production and improvement in profits, and this suggested that firms were taking cautious views on the outlook for the economy. In relation to this point, one member -- noting that firms might be formulating their strategies for establishing an optimal production system from a global perspective, or might be determining an appropriate timing for their investment -- expressed the view that developments, including in firms' shifting of production sites to other Asian countries, should continue to be closely monitored.

Members shared the view that <u>the employment and income situation</u> had remained severe but the degree of severity had eased somewhat. Some members said that signs of improvement had continued to be seen in the employment and income situation: for example, the ratio of job offers to applicants was on an uptrend, and household income had exceeded the previous year's level mainly due to the increase in overtime payments. However, a few members expressed the view that firms remained cautious about raising wages or increasing employment amid the persistent sense of an excessive workforce, and therefore a situation continued in which the increase in production and profits did not necessarily lead to a rise in household income.

Members agreed that <u>private consumption</u> had been generally picking up. Some members expressed the view that growth in demand for durable goods, which had continued to be high due to policy effects, had recently slowed as expected, as evidenced by sales of electrical appliances after the start of fiscal 2010. However, some members said that signs of a pick-up in private consumption were seen in areas that had not been directly supported by policy measures: for example, sales at department stores and supermarkets had essentially stopped decreasing and outlays for travel had recently started to recover. Some members expressed the opinion that the pace of pick-up in private consumption was likely to be only moderate for the time being mainly due to the waning effects of the policy measures. One member added that the key was whether an increase in self-sustaining consumer spending led by improvement in the employment and income situation would more than offset a decline in spending following the termination of the policy measures.

Members shared the view that housing investment had recently leveled out, mainly in the Tokyo metropolitan area, and was likely to gradually head for a recovery.

Members agreed that production had been increasing, mainly reflecting high growth in emerging economies and the expansion in global demand for IT-related goods. Some members expressed the view that production was likely to continue rising as a trend reflecting the recovery in overseas economies, although the pace of increase in production would moderate gradually due to the waning effects of policy measures and of inventory restocking.

Members concurred that the CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but excluding the effects of subsidies for high school tuition, the slowing trend in the pace of decline had continued. One member, in view of the fact that the year-on-year rate of decline in the trimmed mean CPI had been moderating, expressed the opinion that the lagged effects of the narrowing of the negative output gap since 2009 had manifested themselves. A different member, noting the record high reached by the figure representing the difference between the number of items for which prices had declined and of items for which prices had risen, said that the persistent downward pressure on prices still required close monitoring. As for the outlook, members agreed that the year-on-year pace of decline in the CPI was likely to slow as the aggregate supply and demand balance improved gradually. A few members pointed to the fact that the results of the Bank's *Opinion Survey on the General Public's Views and Behavior* conducted in June showed that households' one-year-ahead inflation expectations rose somewhat from the March survey.

B. Financial Developments

Members shared the view that financial conditions had continued to show signs of easing.

Many members said that Japan's money market had been stable due in part to the Bank's provision of ample funds, despite the heightened strains in U.S. and European markets. Some members expressed the view that, amid the continued declining trend in firms' funding costs, stimulative effects from low interest rates were beginning to strengthen in light of improved corporate profits.

Some members said that long-term interest rates in Japan had declined significantly through early July, mainly reflecting a decrease in long-term interest rates abroad. One member said that, although fiscal consolidation had recently become a hot topic of discussion in Japan as well, there had not been any significant changes in risk premiums so far. Some members commented that due attention should continue to be paid to whether the declining trend in long-term interest rates would be prolonged.

Members concurred that financial institutions' lending attitudes, as perceived by firms, and firms' financial positions had continued to show signs of improvement as a whole. Some members said that, according to the results of the June 2010 *Tankan* and other surveys, firms judged their financial positions to be as tight as or less tight than the average situation in the previous decade. One member said that the ratio of firms' on-hand liquidity to sales, particularly for small firms, had recently registered a record high. This member added that, on the whole, firms' funding conditions no longer constrained their spending, even for small firms. Some members noted that the degree of improvement in very small firms' funding conditions remained small. One member explained that this situation was partly attributable to significant changes in their business environment amid changes in demographic conditions and the industrial structure. The member continued that, therefore, the essence of the underlying issues might be overlooked if firms' funding conditions were the only focal point.

With regard to the recent appreciation of the yen and fall in Japanese stock prices, some members said that the effects on Japan's economic activity should be examined closely. In relation to this point, some members noted the following developments amid the increased risk aversion among investors around the world: stock prices continued to be unstable not only in Japan but also in overseas markets; and the yen had appreciated partly because investors had no better alternative than to buy yen as safe assets. One member said that it was important to comprehensively assess the effects of the strong yen and weak stock prices, taking into account economic conditions and the market situation at the time. This member added that, when making such assessment, it was also necessary to take into consideration the fact that domestic and overseas economies were recovering and that, compared with the situation in the United States and Europe, money and credit markets in Japan were more stable and Japan's financial system was considerably more robust.

C. Interim Assessment

Given the above assessment of recent developments, members agreed that growth prospects for fiscal 2010 would likely be higher than the Bank's projection presented in the April 2010 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). Many members cited the following as reasons: a faster-than-expected rate of increase in exports mainly due to accelerated growth in emerging economies; and a larger carry-over effect from fiscal 2009 on GDP growth for fiscal 2010 due to the higher-than-expected level of GDP for the last quarter of fiscal 2009. Members concurred that growth prospects for fiscal 2011 would likely remain broadly unchanged compared with the April projection.

With regard to prices, members agreed that the year-on-year rates of change in the CGPI and the CPI (excluding fresh food) would likely be broadly in line with the projections presented in the April 2010 Outlook Report. A few members added that these price forecasts were made in view of both the upside factor of higher growth prospects for fiscal 2010 and the downside factors of the recent fall in commodity prices and appreciation of the yen.

With regard to risks for economic activity, many members noted that the size of upside and downside risks had increased somewhat compared with the April projections, and some members expressed the view that both sets of risks were broadly balanced. As downside risk factors, many members pointed to international financial developments and said that particular attention should be paid to the effects of developments in European fiscal and financial conditions on international finance and the world economy. One member expressed greater concern over the downside risks in the second half of fiscal 2010, in view of fiscal and financial developments in Europe and the possibility that waning of policy effects would depress consumption, of durable goods in particular. Some members also noted the possible consequences of balance-sheet adjustments in the United States and Europe as a downside risk factor. In this regard, one member added that the ongoing balance-sheet adjustments might be dampening expectations for U.S. medium- to long-term economic growth, and this warranted attention. A different member said that Japan's expansionary macroeconomic policy, should it be maintained for longer than necessary, might result in sluggish productivity growth due to a delay with the progress in structural changes, and in a consequent decline in expectations for Japan's medium- to long-term economic growth. On the other hand, as upside risk factors, most members cited even faster growth in emerging and commodity-exporting economies. Some members expressed the view that attention should be paid to the possibility that a shift from accommodative monetary policy might be delayed in emerging economies, for which growth momentum was strong, mainly because these economies were concerned about adverse effects on them from the sluggish recovery in advanced economies. A few members said that if such a policy shift actually lagged behind, emerging economies might face the risk of further overheating and undergo a subsequent rapid unwinding of economic and financial activity. Meanwhile, one member said that the pace of growth in emerging economies might accelerate further, depending on developments in such factors as (1) capital flows from advanced economies to emerging economies and (2) global demand for IT-related goods. With regard to the latter, a different member was of the opinion that it was important to bear in mind that the supply-demand balance for IT-related goods tended to change significantly in a relatively short term, as suggested by past experience. In this regard, another member said that, when examining the effects on Japan's economic activity, it was necessary to keep in mind that upside risk factors and downside ones associated with emerging and advanced economies were complexly intertwined, rather than independent of each other.

As for risks to the outlook for prices, some members said that there was a possibility that inflation would rise more than expected due to an increase in primary commodity prices brought about by higher growth rates in emerging economies, while there was also a risk that the rate of inflation might fall due, for example, to a decline in medium- to long-term inflation expectations. As for the latter risk, one member commented that the Bank, as the central bank, should prevent such a decline in medium- to long-term inflation expectations.

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

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that, given the above assessment of economic activity and prices, it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

As for the future conduct of monetary policy, members agreed that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank should continue to consistently make contributions as central bank. They concurred that, in the conduct of monetary policy, the Bank would continue to aim at maintaining the extremely accommodative financial environment.

Members discussed the fund-provisioning measure to support strengthening the foundations for economic growth, the introduction of which the Bank decided in June. Some members -- noting that 66 financial institutions, including regional banks and *shinkin* banks, had qualified for the measure -- regarded this as a favorable move in that it was consistent with the measure's objective of offering support as broadly as possible for the various efforts that financial institutions would make. Many members said that the measure should also act as a catalyst for private financial institutions to make efforts on their own initiative toward strengthening the foundations for economic growth, and it was important that the measure would lead to a spread of such efforts among financial institutions. On this point, some members said that an increasing number of private financial institutions had already set up funds on the assumption that they would qualify for the measure. One member hoped that many financial institutions would make positive efforts consistent with the objectives of the measure, and in this regard said that it was necessary to consider how the Bank should disclose the results of its loan provision through the measure. A different member expressed the view that, besides this measure, the Bank should continue to explore various possibilities from the central bank's perspective -- for example, toward establishing a market for the purpose of strengthening the foundations for economic growth.

IV. Remarks by Government Representatives

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

(1) The Japanese economy had been picking up steadily, and the foundation for a self-sustaining recovery was being laid. Nevertheless, the situation remained difficult, as evidenced by the high unemployment rate. As for short-term prospects, in addition to risk factors such as international financial developments and deflation, there was continued concern that the employment situation could deteriorate further, and the basis for the economy's return to a path of strong private demand-led growth remained fragile.

(2) In the "New Growth Strategy," which had recently been decided by the Cabinet, the government stated that it regarded overcoming deflation as the top-priority task in its macroeconomic policy management, and would work with the Bank to launch vigorous and comprehensive policy efforts. In the strategy, the government divided the period through fiscal 2020 into two phases and regarded "Phase I" as the "period of overcoming deflation," in which the government aimed to end deflation, making the CPI inflation rate positive by the end of fiscal 2011 and quickly achieving and maintaining a positive inflation rate. It would also make efforts to raise the economic growth rate close to 3 percent in real terms. After ending deflation, the government would maintain an appropriate and stable year-on-year price increase of approximately 1 percent in terms of the GDP deflator. The government, by putting forward the measures specified in the strategy, would strive to eliminate the negative output gap, placing priority on the implementation of measures and programs that were highly effective in creating demand and jobs. In the strategy, the government also stated that it expected the Bank to share the basic perspectives on macroeconomic policy management with it, and make every possible policy effort.

(3) In addition to the "New Growth Strategy," the Cabinet had recently decided the "Fiscal Management Strategy," in which a path toward sound public finance was presented. The government would put the two strategies into action in an integrated manner and do its utmost to achieve their aims.

(4) The Bank recognized, as did the government, that the critical challenge for Japan's economy was to overcome deflation, and presented its view that it would maintain the extremely accommodative financial environment. The government expected the Bank to continue to support the economy from the financial side, for example, with a view to overcoming deflation, by conducting monetary policy in an appropriate and flexible manner, while closely exchanging views with the government.

The representative from the Cabinet Office made the following remarks.

(1) In the government's opinion, the Japanese economy had been picking up steadily and the foundation for a self-sustaining recovery was being laid. Nevertheless, the situation remained difficult, as evidenced by the high unemployment rate. The government aimed to bring about a strong economy, robust public finance, and a strong

social security system by putting forward, in an integrated manner, the measures specified in the "New Growth Strategy" and the "Fiscal Management Strategy," both decided by the Cabinet in June.

(2) In the midyear economic projection for fiscal 2010, which the Cabinet Office released in June as a reference to the two strategies, the government projected a decline in the CPI of about 0.4 percent in fiscal 2010 -- excluding the effects of subsidies for high school tuition -- effectively forecasting that deflation would continue. It also projected that the year-on-year rate of change in the CPI for fiscal 2011 would be about 0.0 percent.

(3) Based on the "New Growth Strategy," the government -- viewing recovery in demand, which was constrained under deflation, as a pressing challenge -- would make policy efforts to eliminate the negative output gap. It regarded overcoming deflation as the top-priority task in its macroeconomic policy management, and thus aimed to make the CPI inflation rate positive by the end of fiscal 2011 and to quickly achieve and maintain a positive inflation rate.

(4) Regarding the level of CPI inflation that the Bank's Policy Board members understood as being consistent with price stability over the medium to long term, or the "understanding," each Policy Board member's "understanding" fell in a positive range of 2 percent or lower and the midpoints of most members' "understanding" were around 1 percent. However, the Bank, in its interim assessment at this meeting of the April 2010 Outlook Report, projected a CPI inflation rate for fiscal 2011 that was only slightly positive. The government expected the Bank to recognize that overcoming deflation was a policy objective that both entities shared. The government also hoped that, during the "period of overcoming deflation" set out in the "New Growth Strategy," the Bank would conduct monetary policy in an appropriate and flexible manner, while sufficiently exchanging views and working together with the government.

(5) The government was working to further improve the credibility of Japan's economic statistics, including the GDP statistics, and also to create an indicator to measure social progress. The government hoped that it would be able to gain the Bank's understanding and cooperation on these efforts.

V. Votes

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 remain at around 0.1 percent.

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

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

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

   The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.1 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. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, and Mr. Y. Morimoto.

Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

Members discussed 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).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 14 and 15, 2010 for release on July 21, 2010.

Attachment

July 15, 2010

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,[6] 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. Japan's economy shows further signs of a moderate recovery, induced by improvement in overseas economic conditions. Exports and production have been increasing mainly due to high growth in emerging economies and increased global demand for IT-related goods. Corporate profits and business sentiment have been improving, and business fixed investment is showing signs of picking up. The employment and income situation has remained severe, but the degree of severity has eased somewhat. In these circumstances, private consumption has been generally picking up. Public investment is declining. Meanwhile, financial conditions have continued to show signs of easing. The CPI (excluding fresh food) is declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline has continued.

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

3. The Bank's baseline scenario projects that the economy is likely to be on a recovery trend. With regard to prices, based on the assumption that medium- to long-term inflation expectations remain stable, the year-on-year rate of decline in the CPI (excluding fresh food) is expected to slow as the aggregate supply and demand balance improves gradually.

4. Compared with the projections presented in the April 2010 *Outlook for Economic Activity and Prices*, growth prospects will likely be higher for fiscal 2010 mainly due to acceleration of growth in emerging economies, but remain broadly unchanged for fiscal 2011. With regard to prices, the year-on-year rates of change in the domestic corporate goods price index and the CPI (excluding fresh food) are expected to be broadly in line with the projections presented in April.

5. With regard to economic activity, there are some upside risks such as even faster growth in emerging and commodity-exporting economies. On the other hand, there are also downside risks such as those related to international financial developments. In this regard, attention should be paid to the effects of developments in fiscal and financial conditions in some European economies on international finance and the global economy. With regard to prices, there is a possibility that inflation will rise more than expected due to a rise in commodity prices brought about by higher growth rates in emerging and commodity-exporting economies, while there is also a risk that the rate of inflation might decline due, for example, to a decline in medium- to long-term inflation expectations.

6. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. To this end, the Bank will continue to consistently make contributions as central bank. In the conduct of monetary policy, the Bank will aim to maintain the extremely accommodative financial environment.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+2.5 to +2.7 [+2.6]	+1.2 to +1.3 [+1.2]	-0.5 to -0.2 [-0.4]
Forecasts made in April 2010	+1.6 to +2.0 [+1.8]	+1.1 to +1.5 [+1.3]	-0.5 to -0.2 [-0.5]
Fiscal 2011	+1.8 to +2.1 [+1.9]	+0.5 to +0.9 [+0.8]	0.0 to +0.2 [+0.1]
Forecasts made in April 2010	+2.0 to +2.2 [+2.0]	+0.5 to +0.8 [+0.7]	-0.1 to +0.2 [+0.1]

Notes: 1. Figures in brackets indicate the median of the Policy Board members' forecasts (point estimates).

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 figure and the lowest figure excluded. The range does not indicate the forecast errors.

3. Individual Policy Board members make their 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 CPI for fiscal 2010 excludes the effects of the introduction of subsidies for high school tuition fees, a factor that will substantially lower the year-on-year rate of change in the CPI for the year. This measure is estimated to lower the year-on-year rate of change in the CPI (excluding fresh food) by approximately 0.5 percentage points.

5. The range shown below includes the forecasts of all Policy Board members.

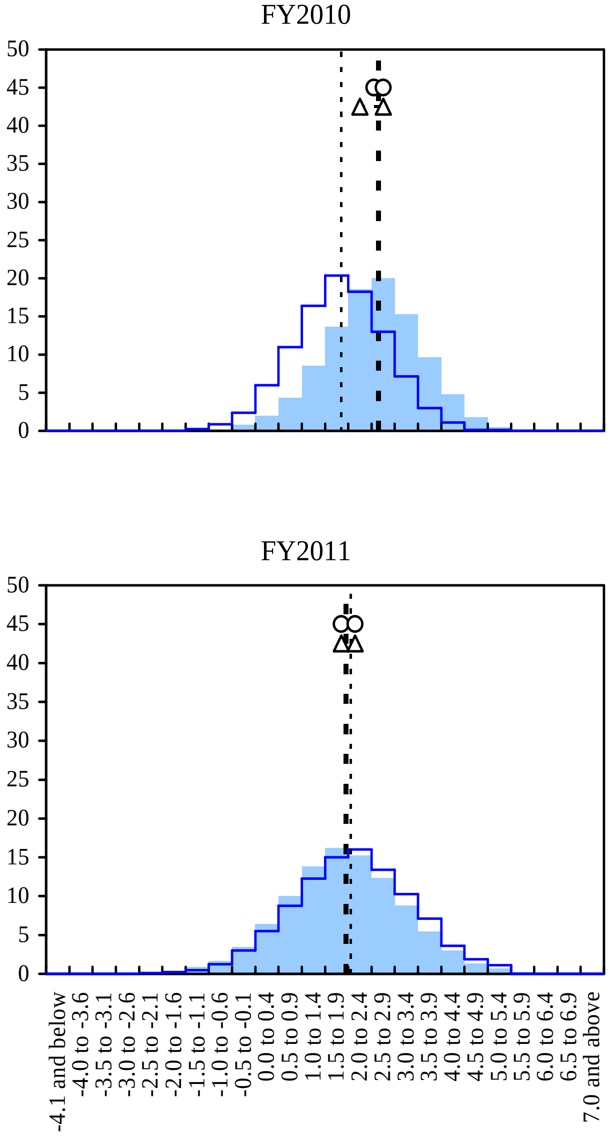
y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+2.2 to +2.7	+1.0 to +1.4	-0.5 to -0.2
Forecasts made in April 2010	+1.5 to +2.0	+1.0 to +1.6	-0.6 to -0.2
Fiscal 2011	+1.8 to +2.1	+0.5 to +1.0	-0.1 to +0.3
Forecasts made in April 2010	+1.9 to +2.4	+0.4 to +1.0	-0.1 to +0.3

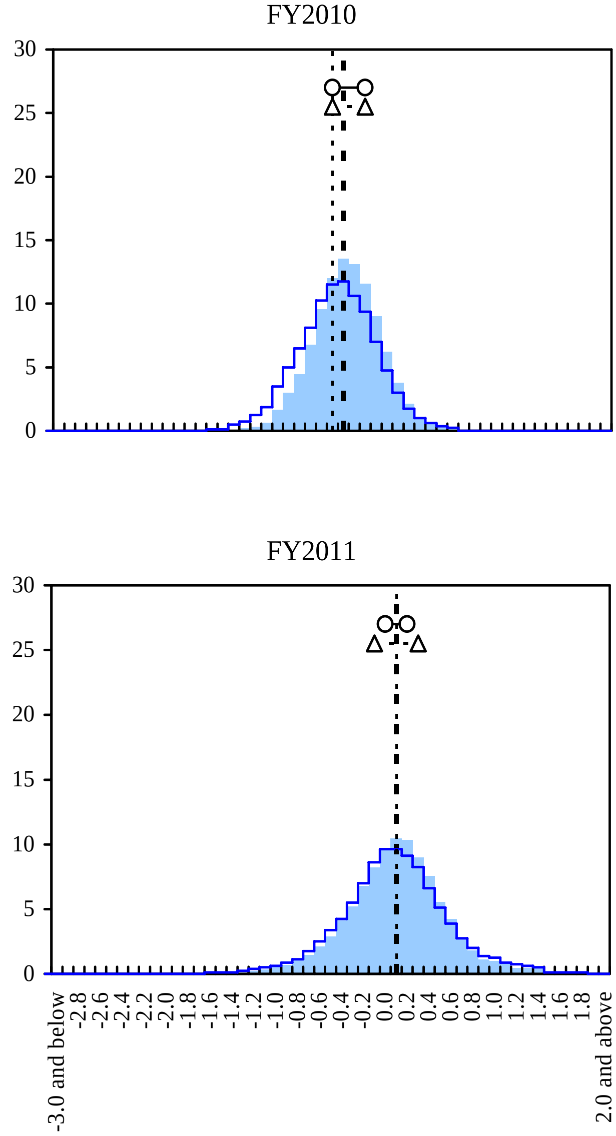
Appendix 2

Risk Balance Charts

(1) Real GDP



(2) CPI (Excluding Fresh Food)



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 July 2010, and solid lines represent those in April 2010.

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 April 2010.

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.*