Not to be released until 8:50 a.m. Japan Standard Time on Friday, February 18, 2011.

February 18, 2011

Bank of Japan

Minutes of the Monetary Policy Meeting

on January 24 and 25, 2011

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Monday, January 24, 2011, from 2:00 p.m. to 4:31 p.m., and on Tuesday, January 25, from 9:02 a.m. to 12:24 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. Sakurai, Senior Vice Minister of Finance, Ministry of Finance[2]
Mr. Y. Kinoshita, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. Y. Suematsu, Senior Vice Minister for Economic and Fiscal Policy, Cabinet Office[2]
Mr. K. Umetani, Director-General, Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. K. Yamamoto, Executive Director
Mr. H. Nakaso, Executive Director (Assistant Governor)
Mr. M. Amamiya, Executive Director
Mr. N. Kinoshita, Executive Director

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on February 14 and 15, 2011 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. Sakurai and Y. Suematsu were present on January 25.

[3] Messrs. Y. Kinoshita and K. Umetani were present on January 24.

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

Mr. T. Kato, Head of Policy Planning Division, Monetary Affairs Department

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

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

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

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

Secretariat of the Monetary Policy Meeting

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

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

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

Mr. M. Minegishi, 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, in accordance with the guideline decided at the previous meeting on December 20 and 21, 2010 and in consideration of the recent formation of market rates, conducted money market operations in a flexible manner.[5] In the Bank's funds-supplying operation, undersubscription had occurred, in that bids fell short of the Bank's offers. The uncollateralized overnight call rate had been slightly below the 0.1 percent level.

B. Recent Developments in Financial Markets

Money market rates had been stable as a whole, against the background of the Bank's provision of ample funds. General collateral (GC) repo rates had been stable at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had decreased somewhat, and, including those with a one-year maturity, had recently been in the range of 0.10-0.15 percent. Longer-term interbank rates had been more or less unchanged.

Long-term interest rates in Japan had fallen temporarily -- as the rise in U.S. long-term interest rates had paused and position adjustments made by investors had abated -- and then increased somewhat; the benchmark rate had been in the range of 1.2-1.3 percent. Yield spreads between corporate bonds and Japanese government bonds (JGBs) had been more or less flat at low levels. Stock prices had risen, partly due to the continued purchases of Japanese stocks by foreign investors in a situation where U.S. stock prices were steady, and the Nikkei 225 Stock Average had been at around 10,500 yen. In the foreign exchange market, the yen, after appreciating to some extent against the U.S. dollar during the period around the turn of the year, had depreciated somewhat and had recently been in the range of 82-83 yen.

C. Overseas Economic and Financial Developments

The world economy had continued to recover.

The U.S. economy had continued to recover at a moderate pace. Exports were

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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 to 0.1 percent.

continuing to increase and business fixed investment was rising moderately. Private consumption had continued to increase, but the pace of recovery remained moderate as a trend in a situation where the employment situation had not improved noticeably, as seen in the high unemployment rate, for example. Housing investment remained at a depressed level. As for prices, although the effects of the rise in international commodity prices had been observed, 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 due to slack in supply and demand conditions and a decline in unit labor costs.

Economic activity in the euro area as a whole was recovering moderately, with some differences in pace by country. Exports had continued to increase, although the pace was slowing, and domestic demand components such as private consumption had been rising gradually. As for prices, although the effects of the earlier depreciation of the euro and of the rise in international commodity prices had been observed, slack in supply and demand conditions and slower growth in wages were exerting downward pressure on the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food. U.K. economic conditions were recovering at a moderate pace.

The Chinese economy continued to show relatively high growth. Growth in private consumption had been firm due mainly to households' higher income levels, and fixed asset investment had continued to show high growth. Exports were on a rising trend, and the pace of increase in production was accelerating again. Economic conditions in the NIEs and the ASEAN countries had been on a recovery trend. As domestic and external demand continued to be on an increasing trend, the shipment-inventory balance had improved and the deceleration phase for production was coming to an end. 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 gradually due to higher food and materials prices, reflecting the effects of the rise in international commodity prices and greater utilization of production factors such as labor and capital.

As for global financial markets, although stock prices had weakened temporarily due to uncertainty regarding fiscal problems in some peripheral European countries, stock prices rose compared with the levels at the previous meeting due to the improvement in the economic outlook and expectations for higher corporate profits. While long-term interest rates in the United States had been more or less unchanged, those in Germany had risen somewhat compared with the levels at the previous meeting, reflecting further improvement in economic sentiment. Although the yield spreads of government bonds issued by some peripheral European countries over those issued by Germany remained unstable at high levels, they had narrowed somewhat against the background of successful bond auctions, partly reflecting expectations for a further support package by the European Union and for an increase in the amount of purchases of government bonds by the European Central Bank.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had been somewhat weak. They were expected to increase moderately again, reflecting the improvement in overseas economic conditions.

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

With regard to domestic private demand, business fixed investment had started to pick up. Signs of picking up in business fixed investment were expected to gradually become more evident as the improvement in corporate profits continued. However, with firms' persistent sense of excessive capital stock, the pace of improvement in business fixed investment was likely to remain moderate.

The employment and income situation had remained severe, but the degree of severity had eased somewhat.

With regard to private consumption, demand for some goods had suffered a reverse after the sharp increase seen previously. Private consumption was expected to pick up again as the reverse following the sharp increase in demand became less pronounced.

Housing investment was showing signs of picking up, and was expected to pick up gradually, considering the number of housing starts.

Production had declined slightly, but was expected to resume a moderate increasing trend.

As for prices, international commodity prices had increased. The three-month rate of change in the domestic corporate goods price index (CGPI) was rising moderately, mainly due to the increase in international commodity prices. The CGPI was expected to remain on an uptrend for the time being, reflecting movements in international commodity prices. 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 ease further. 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 had continued to see financial institutions' lending attitudes as improving. Issuing conditions for CP and corporate bonds had become more favorable, as seen in an increased variety of corporate bond issuers. 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. On the other hand, the outstanding amount of corporate bonds had exceeded the previous year's level, and the pace of decline in that of CP had been on a decelerating trend. In these circumstances, firms' financial positions had been improving as a whole. Meanwhile, the year-on-year rate of increase in the money stock had been in the range of 2.0-2.5 percent.

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

A. Economic Developments

Members discussed the economic and financial conditions abroad, and agreed that overseas economies had continued to recover, led by high growth in emerging and commodity-exporting economies, and that the growth rates of overseas economies had started increasing again.

Members shared the view that the U.S. economy had continued to recover at a moderate pace. Most members said that private consumption had been firm recently, as seen in the moderate increase in car sales and the favorable year-end sales results. As background to this view, some members pointed to the wealth effects stemming from the rise in stock prices. With regard to developments in the corporate sector, some members commented that exports were continuing to increase, supported by demand from emerging economies, and that business fixed investment was rising moderately. Many members were of the view that concerns about the outlook for the U.S. economy had subsided somewhat, as many economic indicators had been steady recently and policy actions such as the Federal Reserve's further monetary easing measures and the U.S. government's extension of tax cuts had been taken toward the 2010 year-end. However, many members noted that the housing market remained sluggish and the employment and income situation had not improved noticeably, as seen in the slow pace of increase in the number of employees in the private sector and the high unemployment rate. Many members expressed the view that improvement in the employment and income situation and a repairing of balance sheets were vital to achieving a full-fledged recovery in consumption, and therefore the pace of recovery in the U.S. economy would likely remain moderate for the time being.

Members agreed that economic activity in the euro area as a whole was recovering moderately, with some differences in pace by country. Many members pointed to the favorable economic conditions, supported by exports in core countries in particular, such as Germany. However, many members expressed the view that, due partly to the effects of fiscal austerity, severe conditions continued in some peripheral countries that were facing fiscal problems, and disparities between these peripheral countries and core countries were becoming noticeable. One member was of the opinion that, amid the noticeable disparities in the euro area, it was becoming increasingly difficult to conduct monetary policy for the euro area as a whole.

Members concurred that the Chinese economy had continued to show relatively high growth. Some members expressed the view that, amid a continued solid increase in domestic demand, exports were on a rising trend and the pace of increase in production was accelerating again, suggesting that China's growth rate had been accelerating again recently. Most members expressed the opinion that, despite the rises in renminbi benchmark rates and the reserve requirement ratio, the financial environment seemed to remain extremely accommodative and inflationary pressure had not been contained sufficiently. On this point, one member expressed the view that the effects of monetary easing in advanced economies had begun to spread through China as inflationary pressure under a relatively inflexible foreign exchange rate regime.

Some members were of the opinion that the NIEs and the ASEAN economies had begun to move out of the production adjustment phase, as the Purchasing Managers' Index (PMI) for new export orders had recently shown some improvements and exports, particularly to China, were rising again. In this situation, a few members expressed the view that, like China, inflationary pressure had been increasing because the financial environment in these economies remained extremely accommodative.

Most members were of the view that global financial markets had been stable as a whole, on the back of improving market perceptions of the outlook for the U.S. economy, but there was still instability in Europe due to the sovereign risk problem. One member said that it would take some time for this problem to be solved, but that a worsening had been curbed because a further deterioration in fiscal conditions in peripheral European countries had been avoided and policy actions such as the establishment of the European Financial Stability Facility had been taken. Nevertheless, some members said that market participants were anxious about the large amount of government bonds due for redemption in the spring in some countries. In relation to this, a few members expressed the view that, if governments were forced to roll over at a higher interest rate, this could have a significant influence on current plans to achieve sound public finance.

With regard to international commodity prices, members discussed the continuing price rises in a wide range of items such as crude oil, nonferrous metals, and grain. As background to the recent rise in international commodity prices, many members expressed the view that this was in essence due to the increase in demand underpinned by growth in emerging economies, while also pointing to temporary factors such as heightened concerns about supply owing to adverse weather. In addition to the actual demand, a few members expressed the view that the increase in the inflow of speculative funds to the commodity markets was a factor behind the rise in commodity prices, amid financialization of commodities and accommodative monetary conditions in advanced economies. In support of this view, one member commented that the current phase showed the correlation between stock prices and international commodity prices had become extremely high. Some members were of the view that international commodity prices would continue to be on an uptrend supported by demand in emerging economies, but at the same time were likely to continue to be highly volatile reflecting the increasing effects of the inflow of speculative funds. One member expressed the view that, given these circumstances, it was important to closely examine whether the rise in international commodity prices was in line with the developments in economic fundamentals. One member said that, as a channel through which the effects of monetary easing in advanced economies spread, the rise in commodity prices -- leading to upswings in commodity-exporting economies and thereby influencing business performance and stock prices of multinational companies operating in those economies -- seemed to play not a small role.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. They concurred that the economy still showed signs of a moderate recovery, but the recovery seemed to be pausing at present. As for the outlook, however, members shared the view that Japan's economy was likely to gradually overcome the deceleration in the pace of improvement and return to a moderate recovery path. Many members raised the following as factors behind this outlook: (1) exports were likely to increase moderately again as the growth rate of the global economy was starting to increase again; and (2) the effects of the reverse following the sharp increase in demand for cars on consumption and production would wane. Many members expressed the view that it had become more likely that the economy would return to a moderate recovery path. Regarding the timing of such a development, one member said that -- although some uncertainty remained -- it could occur around the spring given that the risk of a significant delay had subsided. One member also commented that, based on anecdotal information from firms, it was quite possible to envisage the economy returning to a moderate recovery path sometime during the January-March quarter of 2011. Nevertheless, some members expressed the view that, even though the probability of the economy returning to a moderate recovery path had increased, subsequent economic developments remained uncertain.

Turning to developments in each demand component, members agreed that exports had been somewhat weak due to the effects of the yen's appreciation to date, in addition to developments in inventory adjustments in some IT-related goods. Nevertheless, regarding the outlook, they shared the view that exports were likely to increase moderately again, as the growth rate of the global economy was starting to increase again and inventory adjustments in IT-related goods seemed to be making progress underpinned by steady final demand.

Members concurred that business fixed investment had started to pick up. They agreed that signs of picking up in business fixed investment were likely to gradually become more evident as the improvement in corporate profits continued, but the pace of improvement in business fixed investment was likely to remain moderate with firms' persistent sense of excessive capital stock.

Members shared the view that the employment and income situation had remained severe, but the degree of severity had eased somewhat. In this situation, with regard to private consumption, members agreed that demand for some goods such as cars had suffered a reverse after the sharp increase seen previously. A few members, however, said that domestic car sales had recovered somewhat at the 2010 year-end, and the effects of the reverse following the sharp increase in demand were gradually becoming less pronounced. A few members expressed the view that sales at retail stores, such as department stores, had been firm, possibly reflecting the rise in stock prices. One member said that, although there had been large fluctuations in consumption of durable consumer goods recently, private consumption seemed to have been solid as a trend, considering that the year-on-year rate of change in winter bonus payments appeared to have turned positive and stock prices were rising. Members shared the view that private consumption was likely to pick up again as the reverse following the sharp increase in demand became less pronounced. A few members, however, expressed concern that the outlook for private consumption remained highly uncertain, since demand in durable consumer goods had been partly brought forward by various demand-boosting policy measures. Members shared the view that housing investment was showing signs of picking up. One member commented that construction starts of owner-occupied homes and houses for sale were increasing, due partly to the effects of various measures to promote housing purchases.

Members agreed that production had declined slightly, partly because domestic car sales, in light of the expiration of subsidies for purchasers of environmentally friendly cars, had decreased following the sharp increase in a situation where exports had been weak. They concurred that production was likely to resume a moderate increasing trend, as exports were likely to increase moderately again and the effects of the reverse following the sharp increase in demand for cars were likely to become less pronounced. On this point, some members expressed the view that, based on developments in the production forecast index and anecdotal information from firms, there was an increasing probability of production turning upward in the January-March quarter.

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 the slowing trend in the pace of decline had continued and was likely to be maintained. Many members raised the possibility that the effects of the recent rise in international commodity prices would spill over to consumer prices. One member commented that it was likely that the rise in international commodity prices would cause an increase in food and energy prices, and that this in turn would affect prices of other goods and services through the input-output structure of Japanese industries. On the other hand, some members expressed the view that, even if the rise in international commodity prices were to be passed through to prices of final consumer goods, the extent to which this could be done was likely to be limited given the prolonged substantial slack in the economy as a whole. Some members said that they continued to hold a cautious view regarding the momentum in terms of bringing the inflation rate closer to the level of medium- to long-term inflation expectations. As background to this view, one member commented that the slope of the Phillips curve had become more flat and the labor share would likely remain at a low level as a trend.

B. Financial Developments

Members shared the view that financial conditions had continued to ease further. A few members expressed the view that, considering the present financial conditions as a whole, there were areas that could be judged as having already reached the state of being accommodative and those that still could not be described as accommodative. They continued that the latter nevertheless had been improving and were closer to becoming accommodative. On this point, one member expressed the view that financial conditions overall had continued to ease further, although there remained areas that could not be described as accommodative, as the stimulative effects from low interest rates were still constrained, given current developments in prices, and financial conditions for some small firms continued to be severe. Many members said that the money market had been stable against the background of the Bank's provision of more ample funds. Some members were of the view that Japanese long-term interest rates, while rising somewhat toward the 2010 year-end, had been regaining stability in a situation where U.S. long-term interest rates had been more or less unchanged. A few members pointed to the possibility that the rise in stock prices and pause in the appreciation of the yen were positively affecting business sentiment. Some members commented that it was necessary to carefully examine the effects on small firms' funding conditions of the expiration of the emergency guarantee program, scheduled at the end of March 2011.

C. Interim Assessment

Given the above assessment of recent developments, members agreed that, compared with the projections presented in the October 2010 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), growth prospects would likely be higher for fiscal 2010, mainly due to (1) a larger carry-over effect from fiscal 2009 on GDP growth for fiscal 2010 reflecting the revision of past GDP statistics and (2) somewhat stronger GDP figures for the first half of fiscal 2010, but remain broadly unchanged from the October projections for fiscal 2011 and 2012.

With regard to prices, members concurred that the year-on-year rates of change in the CGPI and the CPI (excluding fresh food) would likely be somewhat higher in fiscal 2011, mainly due to the rise in international commodity prices, but broadly in line with the October projections for fiscal 2012. One member, however, added that the extent of the upward revision in the CPI forecast for fiscal 2011 was marginal, and therefore this upward revision should not be overly emphasized at this point given the high uncertainty about the outlook.

Regarding risks for economic activity, many members expressed the view that upside and downside risks were broadly balanced. Most members pointed to some upside risks, such as faster growth in emerging and commodity-exporting economies due to robust domestic demand and capital inflows from overseas. Many members were of the opinion that attention should continue to be paid to an upside risk of faster growth in emerging economies in the short term, but also to a risk in the longer term that a delay in the implementation of monetary tightening measures would aggravate the swings in economic activity and consequently undermine the sustainable growth of these economies.

Most members cited future developments in advanced economies as downside risks. As for the U.S. economy, many members expressed the view that, although concerns about the outlook for the economy had subsided, economic activity still looked unlikely to accelerate and remained vulnerable to the downside due to the downward pressure from balance-sheet adjustments. A few members noted that, given that the economy continued to be burdened with balance-sheet adjustments, the prevailing view among market participants about the economic outlook might be somewhat too optimistic, as had been the case in the first half of 2010. A few members said that, since market views regarding the outlook for the U.S. economy would likely continue to fluctuate between optimism and pessimism, due attention should continue to be paid to the effects on Japan's economy of future developments in U.S. economic activity, and of the associated changes in U.S. long-term interest rates and foreign exchange rates as well as market sentiment. Regarding European economies, many members said that risks had relatively increased. Some members expressed the opinion that due attention should be paid to the possibility that further intensification of the sovereign risk problem would bring about more severe fiscal austerity and instability in the financial system, thereby exerting downward pressure on economic activity and causing an adverse feedback loop among fiscal conditions, the financial system, and the real economy. A few members expressed the view that, if global financial markets and the financial system became unstable, triggered by the intensification of the sovereign risk problem, the adverse effects of such instability would spill over to Japan's economy to a considerable extent. One member expressed the view that the market's perception of Japan's fiscal problem warranted attention. A few members were of the opinion that attention should also be paid to the possibility that a continued rise in international commodity prices would have negative effects on Japanese firms' profits through a deterioration in the terms of trade. However, one member said that, if the further rise in international commodity prices had been caused by faster growth in emerging and commodity-exporting economies, this would have positive effects on Japan's economy -- for example, an increase in exports. A different member added that the recent slight appreciation of the yen would partly offset the adverse impact from the rise in international commodity prices on Japan's terms of trade. One member expressed the opinion that there was a risk that the rise in international commodity prices might increase protectionist actions, such as the imposing of export restrictions by commodity-exporting economies.

As for risks to the outlook for prices, many members said that there was a possibility that inflation would rise more than expected if international commodity prices increased further due to high growth rates in emerging economies, while there was also a risk that the rate of inflation would deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations. Regarding the latter risk, a few members referred to the Bank's December 2010 *Opinion Survey on the General Public's Views and Behavior*, which suggested that households' inflation expectations for the next five years had decreased slightly from the September survey, and said that future developments in the public's inflation expectations warranted more careful examination. Many members commented on the revision of the base year for the CPI, which was scheduled to take place in summer 2011. Some members expressed the view that the Bank should examine price developments by acknowledging the likelihood that the year-on-year rate of change in the CPI would be revised downward due to the revision of the base year. A few members expressed the opinion that the revision was merely a technical change, and it was more important to carefully examine changes in the aggregate supply and demand balance in order to determine whether there were any prospects for Japan's economy to overcome deflation. A few members were of the view that, if a downward revision of the year-on-year rate of change in the CPI did happen due to the revision of the base year for the CPI, attention needed to be paid to whether such a revision affected the inflation expectations of economic entities.

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 to 0.1 percent.

As for the future conduct of monetary policy, members concurred that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, it was necessary that the Bank continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. They also agreed that the Bank would continue to carefully examine the outlook for economic activity and prices, and take policy actions in an appropriate manner.

Members discussed the effects of the Bank's comprehensive monetary easing. As for the effects of encouraging a decline in risk premiums, many members cited the narrowing of credit spreads on corporate bonds and the increase in prices for Japan real estate investment trusts (J-REITs). Adding to this, some members expressed the opinion that the comprehensive monetary easing had been acting as a catalyst for an increase in the transaction volume of J-REITs and exchange-traded funds (ETFs), and for an increasing variety of corporate bond issuers. With regard to the effects of encouraging a decline in longer-term interest rates, one member expressed the view that the effects of the comprehensive monetary easing were difficult to see at present given that the level of long-term interest rates had risen somewhat. This member continued, however, that since the degree of the rise in Japanese long-term interest rates -- even amid the rise in stock prices -- was marginal compared with that in U.S. and European long-term interest rates, the comprehensive monetary easing had been effective in constraining the rise in interest rates. In relation to one of the purposes of the policy -- that is, to influence longer-term interest rates -- some members were of the view that it was important for the Bank to secure market confidence in its policy time horizon, and in doing so, explain consistently to the public that it would maintain the virtually zero interest rate policy until it judged that price stability was in sight. One member expressed the opinion that, since the Bank had taken a step to implement extraordinary measures as the central bank, the public was gradually becoming more aware of a long-term downtrend in the growth potential, which was the fundamental problem facing Japan's economy, and this was broadly considered one of the policy effects. A few members, while acknowledging that it was important for the Bank to continue conducting money market operations in a flexible manner in response to changes in the market situation, commented that the guideline for money market operations was decided at Monetary Policy Meetings, and that the Bank's communication regarding its conduct of monetary policy was not made through the daily market operations or the changes in the outstanding balance of current accounts at the Bank.

IV. Remarks by Government Representatives

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

(1) Although economic movements in Japan appeared to be pausing, there were some movements toward a pick-up. However, the situation remained difficult, as evidenced by the high unemployment rate, and there was also a risk that the economy might be

depressed by a possible slowdown in overseas economies as well as fluctuations in global financial markets. It should also be noted that there was still a risk of deflation adversely influencing the economy and a concern about a possible deterioration of the employment situation.

(2) Based on the "Three-Step Economic Measures for the Realization of the New Growth Strategy" (hereafter "Three-Step Economic Measures"), the government -- in order to seamlessly implement the third step, comprising mainly the budget for fiscal 2011, which placed emphasis on economic growth and employment -- had submitted the budget to the Diet on January 24. The government would work to promptly obtain the Diet's approval of the budget.

(3) In order to achieve economic growth in the international community, it was important for Japan to tap the increasingly vigorous growth of Asia, for example. The government would promote mutual efforts by the public and private sectors toward encouraging overseas developments in infrastructure-related business, as well as strengthen the functions of the Japan Bank for International Cooperation. The government would also work to support small firms seeking to develop their overseas business.

(4) Restoring fiscal health had become a critical challenge, and therefore the government -- in line with the measures set forth in the "Fiscal Management Strategy" -- would continue to work on halving the primary balance deficit relative to GDP by fiscal 2015 and achieving a surplus by fiscal 2020. With regard to the basic policy on reform of the social security system decided by the Cabinet in December 2010, the government would conduct an examination in an integrated manner on the reform of the social security system as well as that of the tax system, in which it would simultaneously manage to secure the necessary fiscal resources for the social security reform and restore fiscal health. Together with the timetable for these reforms, the government would formulate a concrete plan by the middle of 2011, aim to secure public consensus, and subsequently carry out these reforms.

(5) The government expected that the Bank would conduct money market operations, with consideration given to firms' concerns about their funding conditions toward the fiscal year-end, and support the economy from the financial side by continuing to actively

conduct monetary policy in an appropriate and flexible manner while keeping close contact with the government.

The representative from the Cabinet Office made the following remarks.

(1) In the "Fiscal 2011 Economic Outlook and Basic Stance for Economic and Fiscal Management," which was decided by the Cabinet on January 24, the Japanese economy was expected to pick up in fiscal 2011 amid expectations of a modest recovery of the world economy. Real and nominal GDP growth rates were expected to be around 1.5 and 1.0 percent, respectively, while the rate of increase in the CPI was forecasted to be approximately 0.0 percent.

(2) The Japanese economy remained in a difficult situation. As for risks to the outlook, attention should be paid to a possible slowdown in overseas economies and movements in the foreign exchange markets.

(3) In order for the Japanese economy to emerge from its current economic pause, and to ensure the overcoming of deflation as well as secure steps toward economic recovery, the present period is crucial. Therefore, based on the "Three-Step Economic Measures," the government had been supporting the economy from both the economic and employment sides by implementing the first and the second steps. It would continue to further promote these economic measures and work to seamlessly implement the third step, comprising largely the budget and the tax-system revision for fiscal 2011, which placed emphasis on economic growth and employment. The government would also work toward overcoming deflation, as set out in the "New Growth Strategy," by making the CPI inflation rate positive by the end of fiscal 2011 and quickly achieving a stable positive inflation rate.

(4) The Bank's interim assessment of the October 2010 Outlook Report was discussed at this meeting, and the government deemed that the Bank and the government broadly shared the same view on current economic conditions. It expected the Bank to continue to aim at overcoming deflation swiftly and underpin the economy, by conducting monetary policy in an appropriate and flexible manner while sufficiently exchanging views and working closely with the government.

V. Votes

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

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

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

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

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

2. A public statement will be decided separately.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, 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 December 20 and 21, 2010 for release on January 28, 2011.

Attachment

January 25, 2011

Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote,[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 to 0.1 percent.

2. Japan's economy still shows signs of a moderate recovery, but the recovery seems to be pausing. Business fixed investment has started to pick up. The employment and income situation has remained severe, but the degree of severity has eased somewhat. As for private consumption, demand for some goods has suffered a reverse after the sharp increase seen previously. Housing investment is showing signs of picking up. On the other hand, exports have been somewhat weak. With these developments in demand both at home and abroad, production has declined slightly. Meanwhile, financial conditions have continued to ease further. 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.

3. The Bank's baseline scenario projects that Japan's economy is expected to gradually overcome the deceleration in the pace of improvement and return to a moderate

[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.

recovery path as the growth rate of the global economy is likely to start increasing again led by emerging and commodity-exporting economies. As for prices, the year-on-year rate of decline in the CPI is expected to continue slowing.

4. Compared with the projections presented in the October 2010 *Outlook for Economic Activity and Prices*, growth prospects will likely be higher for fiscal 2010 mainly due to the revision of past GDP statistics, but remain broadly unchanged for fiscal 2011 and 2012. With regard to prices, the year-on-year rates of change in the domestic corporate goods price index and the CPI (excluding fresh food) will likely be somewhat higher in fiscal 2011 mainly due to the rise in commodity prices, but broadly in line with the October projections for fiscal 2012.

5. In the area of economic activity, there are some upside risks such as faster growth in emerging and commodity-exporting economies due to robust domestic demand and capital inflows from overseas. However, although concerns about the U.S. economy have subsided, there are downside risks associated with uncertainties about the outlook for the U.S. and European economies and developments in global financial markets. Regarding the outlook for prices, there is a possibility that inflation will rise more than expected if commodity prices increase further due to high growth rates in emerging and commodity-exporting economies, while there is also a risk that the rate of inflation will deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations.

6. In order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank will continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. The Bank will continue to carefully examine the outlook for economic activity and prices, and take policy actions in an appropriate manner.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+3.3 to +3.4 [+3.3]	+0.5 to +0.6 [+0.5]	-0.4 to -0.3 [-0.3]
Forecasts made in October 2010	+2.0 to +2.3 [+2.1]	+0.7 to +0.9 [+0.9]	-0.5 to -0.3 [-0.4]
Fiscal 2011	+1.4 to +1.7 [+1.6]	+0.7 to +1.2 [+1.0]	0.0 to +0.4 [+0.3]
Forecasts made in October 2010	+1.5 to +1.9 [+1.8]	+0.4 to +0.7 [+0.5]	0.0 to +0.3 [+0.1]
Fiscal 2012	+1.9 to +2.2 [+2.0]	+0.5 to +0.8 [+0.7]	+0.2 to +0.8 [+0.6]
Forecasts made in October 2010	+2.0 to +2.4 [+2.1]	+0.3 to +0.8 [+0.6]	+0.2 to +0.8 [+0.6]

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

2. The forecasts of the majority of the 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 revised forecasts for real GDP in fiscal 2010 are largely attributable to the revision of past GDP statistics.

5. The CPI forecasts for fiscal 2010 exclude the effects of subsidies for high school tuition, a factor that will significantly push down the year-on-year rate of change in the index for twelve months. This measure is estimated to push down the CPI (excluding fresh food) by about 0.5 percentage points.

6. The CPI forecasts are predicated on the 2005-base CPI. The statistics authority has announced that the base year for the CPI is scheduled to be changed to 2010 in August 2011, and year-on-year figures as far back as January 2011 are scheduled to be revised retroactively. This rebasing is likely to cause the year-on-year rate of increase in the CPI to be revised downward.

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

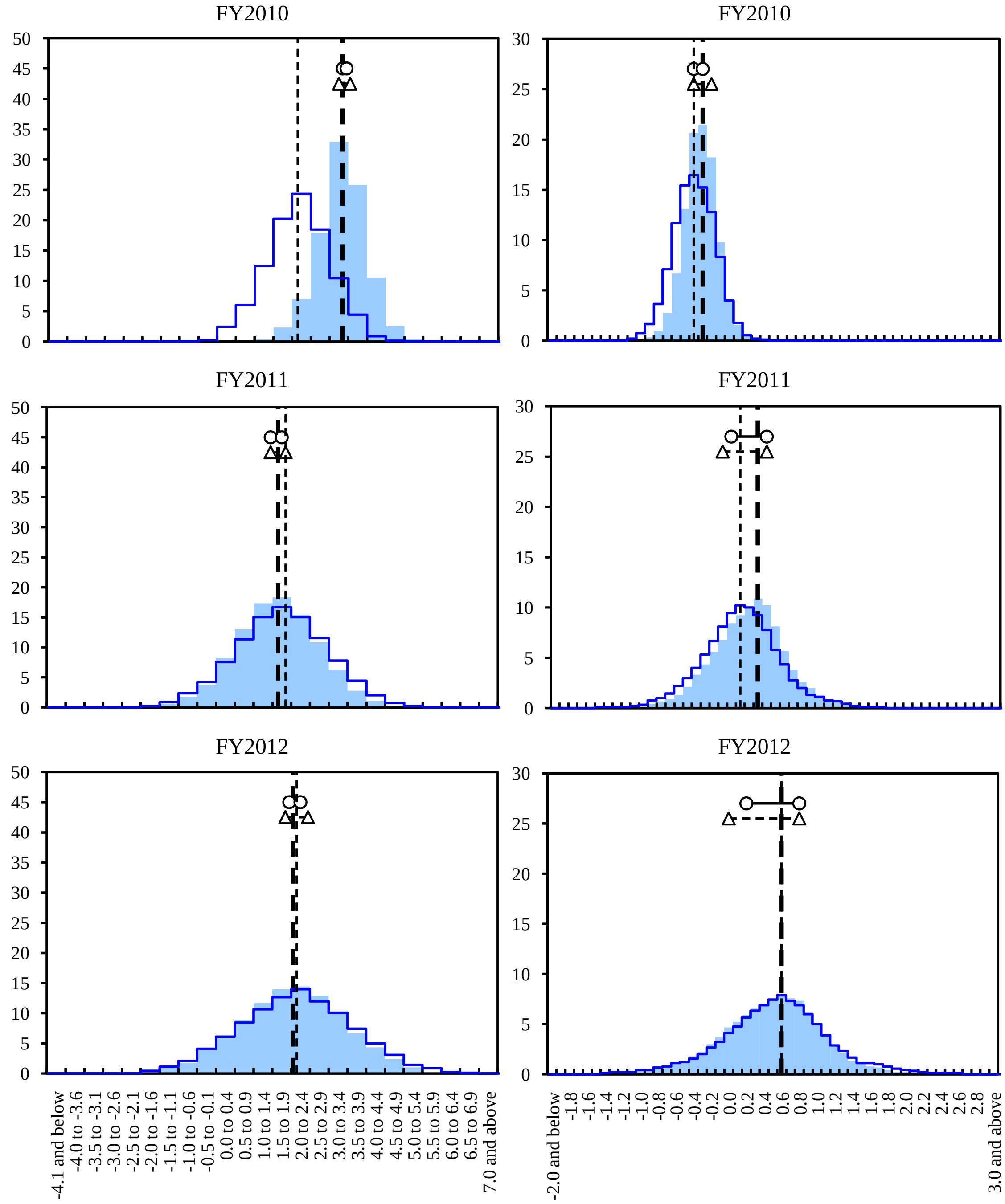
y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2010	+3.2 to +3.5	+0.4 to +0.6	-0.4 to -0.2
Forecasts made in October 2010	+2.0 to +2.3	+0.5 to +0.9	-0.5 to -0.2
Fiscal 2011	+1.4 to +1.8	+0.6 to +1.2	-0.1 to +0.4
Forecasts made in October 2010	+1.5 to +1.9	+0.4 to +1.0	-0.2 to +0.4
Fiscal 2012	+1.8 to +2.4	+0.3 to +1.0	0.0 to +0.8
Forecasts made in October 2010	+2.0 to +2.4	+0.3 to +1.0	0.0 to +0.8

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 January 2011, and solid lines represent those in October 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 October 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*.