Not to be released until 8:50 a.m. Japan Standard Time on Tuesday, August 9, 2011.

August 9, 2011

Bank of Japan

Minutes of the Monetary Policy Meeting

on July 11 and 12, 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, July 11, 2011, from 2:00 p.m. to 4:08 p.m., and on Tuesday, July 12, from 9:00 a.m. to 1:15 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
Mr. S. Nakamura
Mr. H. Kamezaki
Mr. R. Miyao
Mr. Y. Morimoto
Ms. S. Shirai
Mr. K. Ishida

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. T. Fukuyama, Deputy Chief Cabinet Secretary, 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)[4]
Mr. M. Amamiya, 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 August 4, 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 T. Fukuyama were present on July 12.

[3] Messrs. Y. Kinoshita and K. Umetani were present on July 11.

[4] Mr. H. Nakaso was present on July 12.

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Director-General, Monetary Affairs Department

Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department[5]

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

Mr. S. Aoki, Director-General, Financial Markets Department

Mr. E. Maeda, 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. H. Chida, Head of Policy Infrastructure Division, Monetary Affairs Department[5]

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

Mr. M. Minegishi, Senior Economist, Monetary Affairs Department

[5] Messrs. T. Umemori and H. Chida were present on July 12.

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on June 13 and 14, 2011, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[7] In this situation, the uncollateralized overnight call rate had been at around 0.07 percent.

B. Recent Developments in Financial Markets

In the money market, interest rates, particularly those of longer term instruments, had declined moderately as the sense of an abundance of liquidity had grown further amid the Bank's provision of ample funds. General collateral (GC) repo rates had been at around 0.1 percent. Yields on treasury discount bills (T-Bills) had been slightly above 0.1 percent on the whole, while downward pressure spread to those with somewhat longer maturities, particularly those of one year. Rates on longer interbank term instruments had been more or less unchanged.

The benchmark long-term interest rate had generally been in the range of 1.1-1.2 percent. Japanese stock prices had risen, reflecting the recovery in the industrial production index and rise in U.S. stock prices. The Nikkei 225 Stock Average had recently been at around 10,000 yen. In the foreign exchange market, the yen had moved within a narrow range against the U.S. dollar, remaining at around 81 yen to the dollar recently.

C. Overseas Economic and Financial Developments

The world economy continued to recover, but the pace of recovery was slowing.

The U.S. economy continued to recover, but the pace of recovery was slowing. Private consumption continued to increase against the background of a moderate recovery in the employment situation; nevertheless, in a situation where balance-sheet adjustments continued to weigh on the economy, the pace of increase had been slowing recently due to a decline in real purchasing power brought about by the earlier rise in crude oil prices. Housing investment remained at a depressed level, while housing prices were weak. On

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

[7] The guideline was as follows:

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

the other hand, exports continued to increase, and business fixed investment rose moderately. In such a situation, production remained on an increasing trend, although the pace of increase was slowing partly due to downward pressure from supply-chain disruptions associated with the Great East Japan Earthquake. As for prices, the rate of increase in the consumer price index (CPI) for all items less energy and food, or the core CPI, remained only moderate due to slack in supply and demand conditions in the goods market and the labor market. The year-on-year rate of increase in the CPI for all items moved up as a result of the earlier rise in international commodity prices.

Economic activity in the euro area as a whole continued to recover moderately, with some differences in pace by country. Although the rate of increase in exports and production slowed due to the deceleration in the pace of recovery of the world economy, private consumption and business fixed investment continued to increase moderately, especially in Germany. As for prices, although slack in supply and demand conditions continued to exert downward pressure, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items rose due to the effects of the earlier depreciation of the euro and rise in international commodity prices. Meanwhile, in the United Kingdom, the economy was on a recovery trend, but the pace of recovery was slowing.

The Chinese economy continued to show high growth. Although car sales and production slowed to some extent, domestic demand remained firm overall as fixed asset investment maintained high growth. The Indian economy also continued to grow at a relatively rapid pace, although there were some signs of a slowdown due to the cumulative effects of monetary tightening. Economic conditions in the NIEs and the ASEAN countries continued to be on a recovery trend, as domestic demand stayed firm, although production decreased recently partly due to the ramifications of a substantial decline in production by Japanese automakers. In many of these Asian economies, inflationary pressure continued to be strong against the background of the rise in food and materials prices, reflecting the effects of the hike in international commodity prices, and of the increase in utilization of production factors such as labor and capital.

As for global financial markets, U.S. and European stock prices and long-term interest rates had remained under downward pressure through to end-June, mainly due to concerns about a slowdown in the U.S. economy and uncertainties regarding the debt problem in Greece. They subsequently exhibited a rebound, however, as investors' risk aversion receded, since a consensus had been reached regarding the framework of the financial support program for Greece for the immediate future. Meanwhile, the yield spreads of government bonds issued by some peripheral European countries over those issued by Germany remained unstable in a historically high range, although they were narrowing recently.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports turned to an increase with an easing of the supply-side constraints caused by the earthquake disaster. They were expected to continue increasing as supply-side constraints eased further, against the background of the improvement in overseas economic conditions.

The rate of decline in public investment was decelerating gradually, albeit with fluctuations. Public investment was expected to increase gradually, mainly due to the restoration of damaged social capital.

With regard to domestic private demand, business fixed investment was picking up as a whole. It was expected to increase gradually, aided partly by the restoration of disaster-stricken facilities.

The employment and income situation continued to be severe, partly due to the effects of the disaster.

Private consumption began to pick up on the whole, although weakness remained in evidence with regard to some aspects of consumer behavior, against the background that production had recovered and household sentiment had improved somewhat. Private consumption was expected to continue picking up, with a recovery in production and improvement in household sentiment.

Housing investment, which had been relatively weak due to the disaster, recently showed signs of picking up. It was expected to increase gradually as supply-side constraints eased and disaster-stricken homes were rebuilt.

Production, after declining sharply following the earthquake, recently showed clear signs of picking up with the easing of supply-side constraints. It was expected to continue picking up as supply-side constraints eased further.

As for prices, international commodity prices were flat at high levels after falling back slightly. The three-month rate of increase in the domestic corporate goods price index (CGPI) was slowing as international commodity prices fell back. The CGPI was expected to be more or less flat for the time being, reflecting the developments in international commodity prices. The year-on-year rate of change in the CPI (excluding fresh food) was slightly positive and expected to remain so.

2. Financial environment

Financial conditions generally continued to ease, albeit with weakness observed in the financial positions of some firms, mainly small ones.

The overnight call rate remained at an extremely low level, and the levels of firms' funding costs also continued to be low. Stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds were favorable as a whole, leading to an increased variety of corporate bond issuers. As for credit demand, firms showed signs of increasing their demand for working capital. Against this backdrop, the year-on-year rate of decline in bank lending was slowing. The amounts outstanding of both corporate bonds and CP exceeded the previous year's levels. In these circumstances, firms retained their recovered financial positions on the whole, albeit with weakness observed at some firms, mainly small ones. 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

Members discussed the economic and financial conditions abroad, and shared the view that overseas economies were still recovering at a slower but moderate pace and would continue to recover, led by high growth in emerging and commodity-exporting economies. Regarding the outlook for overseas economies, however, some members were of the view that downside risks to economic activity, as well as upside risks to prices --

particularly in emerging economies -- had increased to some extent.

Members concurred that the U.S. economy continued to recover, but the pace of recovery slowed recently. Many members said that the pace of increase in private consumption and production slowed due to a decline in real purchasing power brought about by the earlier rise in crude oil prices and the effects of supply-chain disruptions associated with the disaster in Japan. Some members expressed the opinion, however, that the economic slowdown would be temporary, as crude oil prices had recently been more or less unchanged after falling back in May and the supply of parts from Japan had resumed. Based on this, these members commented that the pace of economic growth was likely to resume a recovery supported by the accommodative financial environment. In this regard, one member expressed the opinion that the economy was likely to maintain its moderate recovery momentum as corporate profits remained strong, partly due to high growth in emerging economies, and business fixed investment was basically firm. On the other hand, many members, pointing to a delay in recovery of the employment conditions and the housing market, expressed the view that a buoyant recovery would remain less likely for some time, since balance-sheet adjustments continued to weigh on the economy. One member pointed to the possibility that the economy's growth potential itself had declined, given that growth expectations for household income had declined substantially following the financial crisis and remained at low levels thereafter.

Members shared the view that the euro area economy as a whole continued to recover moderately, albeit with large disparities between Germany, where the economy remained strong, and some peripheral countries, which faced sovereign debt problems. Some members noted that the pace of recovery in the euro area economy was likely to remain moderate, considering that fiscal consolidation measures in each euro area country were likely to weigh on the economy. In relation to the sovereign debt problem in Greece, some members commented that, although a serious crisis had been avoided for the time being due to the decision on measures for providing liquidity support to Greece for the immediate future, the fundamental problem facing the economy -- namely, how to reduce the government debt -- had not been solved, and the possibility of the sovereign debt problem spreading to some other peripheral countries therefore could not be denied. One member added that there was a possibility that provision of scheduled financial support would be delayed, since fiscal consolidation and structural reforms might not proceed due to domestic opposition, and that future discussion on the provision of additional financial support, with respect to how Greece's private creditors should share the debt burden, would be attended by some amount of controversy. With regard to sovereign debt problems in some peripheral countries, many members said that there continued to be a risk that the problem might destabilize international financial markets, triggered by various events. They continued that very close attention should be paid to future developments, including the results of the stress test on European financial institutions. One member commented that the effects of interest rate hikes by the European Central Bank should also be monitored carefully because they were necessary for countries with strong growth, such as Germany, but could further aggravate the already severe situation in some peripheral countries.

Members agreed that the Chinese economy maintained its relatively high growth, led mainly by domestic demand. Some members, however, noted that the pace of growth had been decelerating recently, as seen in the fact that car sales and production had slowed to some extent. In relation to this, some members assessed that some deceleration in the growth of the Chinese economy was actually desirable from the standpoint of achieving sustainable growth in the world economy. With regard to prices, many members commented that inflationary pressure remained high, as evidenced by the fact that the CPI in China had posted a high year-on-year rate of 6.4 percent in June, despite monetary tightening and the deceleration in economic growth. One member expressed the view that there was a risk, albeit a small one, that an upward wage-price spiral might appear considering the recent substantial rise in wages. Some members said that monetary tightening was a necessary and appropriate adjustment for the economy. These members continued, however, that policymakers were in a difficult phase in terms of policy conduct, in the sense that monetary tightening, if insufficient, could cause more serious inflation and a subsequent plunge in the economy, and if excessive, could exacerbate stagnation in the world economy. A few members added that, for the Chinese economy to achieve sustainable growth, it would be desirable that policymakers also make appropriate responses from a prudential policy perspective, by paying attention to the risks in the banking sector including maturity and liquidity mismatches as well as credit costs arising from real estate and infrastructure loans.

Some members expressed the view that in the NIEs and the ASEAN countries, economic conditions continued to be on a recovery trend as domestic demand stayed firm, although the pace of increase in production and exports had recently slowed, partly due to the effects of the disaster in Japan. One member commented that there was a risk that a substantial rise in wages and an unstable political situation in some countries could lead to a further increase in inflationary pressure.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. They agreed that economic activity was picking up with an easing of the supply-side constraints caused by the disaster.

Regarding recent developments in the economy, most members said that production, after declining sharply following the earthquake, had recently shown clear signs of picking up with the easing of downward pressure caused by supply-side constraints. Members shared the view that exports had turned to an increase and domestic private demand had also begun to pick up, with some improvement in household and business sentiment. With regard to developments in production, most members pointed out that supply chains were steadily being restored at a faster pace than had been expected initially. Many members noted that the degree of electric power supply constraints on economic activity was less significant than had been anticipated, due to an increase in power supply capacity and to efforts made at firms and households to conserve energy and level out demand. Some members said that production, in effect, was likely to return to the level before the earthquake at some time before September, taking into account information obtained from business contacts. Many members, referring to the fact that exports in May had increased for the first time in three months, pointed to a pick-up in production of cars and their related goods as one of the causes. One member noted that net exports -- namely, exports minus imports -- were likely to improve with the recovery in gross exports, although growth in net exports was likely to be sluggish in the short term due to increases in imports of energy and raw materials and in those related to the procurement of materials and parts from abroad. Many members expressed the view that firms' business fixed investment was picking up as a whole, as suggested by the results of the June 2011 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), in which business fixed investment plans for fiscal 2011 were revised upward from those in the March *Tankan*, mainly in manufacturing. One member, however, said that attention should be paid to the fact that the fixed investment plans of small nonmanufacturing firms had been revised downward, which did not follow the seasonal pattern, together with the fact that the outlook for such firms' business conditions deteriorated. Many members expressed the view that private consumption had begun to pick up on the whole, as evidenced by the increases in the number of new passenger-car registrations, sales of electrical appliances, and sales at department stores. Some members said that household sentiment was recently improving with reference to developments in indicators related to consumer sentiment such as the results of the June *Economy Watchers Survey*. Some members, however, expressed concern about the sluggishness in the pace of recovery in indicators related to the services industry, such as travel, due partly to harmful rumors regarding the ongoing problems at the nuclear power plant in Fukushima Prefecture and the slow recovery in the number of foreign visitors to Japan.

As for the outlook for the economy, members shared the view that, with supply-side constraints easing further and production regaining traction, the economy was likely to return to a moderate recovery path from the second half of fiscal 2011, backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock. Many members expressed the view that the economy was likely to recover at a pace above its potential growth rate in fiscal 2012 given that demand for reconstruction from the private and government sectors would probably continue to increase. Meanwhile, one member said that there was a high likelihood that the economy would follow a moderate recovery path that further deviated downward, in terms of the level of economic activity, from the path projected prior to the earthquake. The member raised the following as reasons behind the downward deviation: constraints on wages and employment associated with the plunge in production and consumption since the earthquake; an acceleration in the shift of Japanese firms' production sites to overseas against the backdrop of the rise in electricity costs and the appreciating trend of the yen; and a resultant decline in growth expectations.

Next, members discussed price developments in Japan. Some members commented that the pace of increase in the CGPI was slowing of late against the backdrop that international commodity prices had been more or less flat recently. Members shared the view that the year-on-year rate of change in the CPI (excluding fresh food) was likely to be slightly positive for the time being and also into the future as the aggregate supply and demand balance improved as a trend. One member noted that the improvement in the aggregate supply and demand balance played a role in the CPI for all items less energy and food having increased by 0.1 percent in May from the previous year, turning positive for the first time since October 2008. The member noted in addition that the improvement also played a role in the steady narrowing in the figure representing the difference between the number of items for which prices had risen and those for which prices had declined, although the figure remained in negative territory. One member said that firms, including those located in nonmetropolitan areas, were passing on to product prices the increase in costs accompanying the earlier rise in international commodity prices. Meanwhile, one member expressed the opinion that the degree to which the increase in international commodity prices spread to the CPI -- through prices of energy and food -- was likely to be limited, based on the member's projection, which took a cautious view on future demand in general. Members concurred that the year-on-year rate of change in the CPI was likely to be revised downward with the change in the base year for the CPI, scheduled to take place in August 2011. Some members expressed the opinion that it was difficult to accurately estimate the degree of the downward revision, while one member said that the year-on-year rate of change might temporarily turn negative again, although only slightly. These members then expressed the view that it was important to closely monitor whether the revision of the year-on-year rate of change might change inflation expectations of firms and households, thereby affecting developments in economic activity and prices. One member added that attention should also be paid to whether the revision might influence the outlook on the economy's overcoming of deflation. A few members said that it was necessary to bear in mind that factors that exerted upward pressure on the rate of change -- namely, increases in the tobacco tax and nonlife insurance costs -- would fall off in October 2011.

B. Financial Developments

Members agreed that financial conditions generally continued to ease, albeit with weakness observed in the financial positions of some firms, mainly small ones.

Members shared the view that money market rates continued to be stable amid the Bank's provision of ample funds. Some members said that yields on longer term instruments, particularly those on T-Bills with six-month and one-year maturities, had recently come under downward pressure as well, against the background that the sense of an abundance of liquidity was growing. Many members commented that firms' financing costs were more or less flat at low levels, and that firms continued to see financial institutions' lending attitudes as being on an improving trend, as suggested by the results of the June *Tankan*. Members concurred that issuing conditions for CP continued to be favorable. Regarding the corporate bond market, some members commented that there was still a mismatch between the stance of issuers of electric company bonds and that of investors. Many members, however, expressed the view that issuing conditions for corporate bonds had become favorable again, as evidenced by the fact that credit spreads on high-rated bonds had more or less declined to the level observed before the earthquake, and as for low-rated bonds, there was an increased variety of issuers. Meanwhile, many members said that the June *Tankan* and various other surveys suggested that firms had retained their recovered financial positions on the whole compared with the situation immediately after the earthquake, albeit with weakness observed at some firms, mainly small ones. Some members said that developments in the financial positions of small firms, including very small ones, continued to warrant careful monitoring, together with how demand for reconstruction would develop.

C. Interim Assessment

Given the above assessment of recent developments, most members expressed the view that growth prospects would likely be somewhat lower for fiscal 2011 compared with the forecasts presented in the April 2011 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). Many members said that this was attributable to a smaller carry-over effect from fiscal 2010 on GDP growth for fiscal 2011, as the downturn immediately after the earthquake, which was more significant than had been anticipated, had resulted in significant negative growth for the fourth quarter of fiscal 2010. One member added that another reason for the member's lowering of the growth prospects was the rise in imports as a result of factors such as increased procurement of power-generating fuels. Many members expressed the view that the scenario presented in the April 2011 Outlook Report -- that the economy would return to a moderate recovery path from the second half of fiscal 2011 -- remained intact, and growth prospects for fiscal 2012 would likely remain broadly unchanged from the April forecasts. With regard to prices, many members expressed the opinion that the year-on-year rates of change in the CGPI and the CPI (excluding fresh food) were likely to be broadly in line with the April forecasts. Meanwhile, a few members said that their forecasts of economic activity and prices were within the projected range in the April Outlook Report, but close to the lower bound. One of these members expressed the view that the member's forecasts of economic growth rates and prices had deviated downward somewhat from the April forecasts.

Members then discussed risk factors for the economic outlook. Regarding risks to economic activity, many members expressed the view that, from a short-term perspective, downside risks stemming from supply-side constraints that had emerged since the disaster were diminishing, due partly to the rapid restoration of supply chains and the improvement in the supply and demand balance of electricity. Some members, on the other hand, said that the impact of the disaster on Japan's economy, especially through changes in household sentiment, still required due attention. In relation to this point, one member expressed concern that the June *Tankan* indicated that the diffusion index of business sentiment in the accommodations as well as the eating and drinking services industries remained significantly negative, not only for the current situation but also for the outlook. Many members said that uncertainty had increased somewhat with regard to the longer-term outlook for electricity supply constraints, and noted that this could negatively affect Japan's economy. These members continued that, if operations at many of the nuclear power plants were to be suspended, electricity supply constraints could exert downward pressure on production, and/or business fixed investment and private consumption could be depressed due to a decrease in corporate profits and households' real purchasing power caused by increased pressure on electricity costs. Many members said that it was necessary to bear in mind the risk that, from a longer-term perspective, growth expectations for Japan's economy might decline if the shift of Japanese firms' production sites to overseas -- as well as the shift in procurement of materials and parts from Japan to other countries -- accelerated due to growing concern over a stable supply of electricity and to an increase in electricity costs. One of these members expressed the view that such moves by firms in the medium to long run would induce a decline in Japan's potential growth rate, and were somewhat different in nature from downside risks that would cause cyclical downturns in economic activity. With regard to overseas economies, many members expressed the opinion that the effects of balance-sheet adjustments on the U.S. economy and the possible consequences of the sovereign debt problems in Europe continued to warrant attention. Many members pointed to the need for careful monitoring of whether emerging economies would achieve price stability and economic growth at the same time, thereby making soft landings. One member noted that the possibility that the effects of an economic downturn in one region would spread to other regions synergistically could not be denied completely.

As for risks to the outlook for prices, some members expressed the view that inflation could rise more than expected as international commodity prices increased further, in a situation where the world economy continued to recover, albeit at a slower pace. Meanwhile, some members pointed to the possibility 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, which could be triggered by the change in the base year for the CPI. In this regard, some other members expressed the opinion that individual consumers might not immediately change their medium- to long-term inflation expectations in response to a downward revision to the year-on-year rate of change in the CPI. On the other hand, a few members said that, given the relationship between price indices and wages, such inflation expectations might decline due to the downward revision. Meanwhile, some members emphasized that it was not short-term inflation expectations that were important for economic activity, but rather medium- to long-term ones -- currently stable at around 1 percent -- and that developments in such expectations would be the key point of focus in assessing prices.

III. Summary of Staff Reports on Extension of the Effective Period of the U.S. Dollar Funds-Supplying Operation against Pooled Collateral

The staff provided the following explanation regarding the extension of the temporary U.S. dollar liquidity swap arrangements proposed by the Federal Reserve Bank of New York as well as the extension of the effective period of the Bank's U.S. dollar funds-supplying operation against pooled collateral.

(1) The Federal Reserve Bank of New York proposed to extend its temporary U.S. dollar liquidity swap arrangements with several central banks (the Bank of Canada, the Bank of England, the European Central Bank, the Swiss National Bank, and the Bank of Japan) through August 1, 2012. In response, these central banks made public on June 29, 2011 the extension of the arrangements, except for the Bank of Japan, which announced on the same day that it would consider the extension at its July Monetary Policy Meeting.

(2) Although there were no particular concerns about Japanese financial institutions'

funding in foreign currencies, it would be appropriate for the Bank -- with the aim of facilitating money market operations as well as ensuring the smooth functioning and stability of the financial markets -- to extend the temporary U.S. dollar liquidity swap arrangement as proposed, as part of the coordinated central bank actions, together with the effective period of the U.S. dollar funds-supplying operation against pooled collateral, through August 1, 2012.

(3) Given the above considerations, the staff proposed to make amendments to relevant principal terms and conditions, including those for the U.S. dollar funds-supplying operation against pooled collateral, and accordingly make these public.

IV. Summary of Discussions on Monetary Policy for the Immediate Future and Extension of the Effective Period of the U.S. Dollar Funds-Supplying Operation against Pooled Collateral

A. Monetary Policy for the Immediate Future

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that 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 <u>the future conduct of monetary policy</u>, 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 confirmed that the Bank would continue to carefully examine the outlook for economic activity and prices, including the effects of the disaster, and take appropriate policy actions as necessary.

With regard to <u>the operation of the Asset Purchase Program (hereafter the Program)</u>, one member said that, considering the recent pick-up in the economy, there was no urgent need to influence market sentiment by increasing the amount of the Program at this stage. This member, however, continued that the potential need for additional monetary easing by affecting longer-term interest rates had not yet decreased, given that there was a risk that the time necessary to achieve price stability would be prolonged. A different member said that, while being aware of the need for additional monetary easing, particularly from the standpoint of further bringing forward the projected timing at which the economy would likely overcome deflation -- through sustainable improvement in business and household sentiment, thereby further securing the pick-up in the economy -- the member would like to wait, for the time being, for information to gather before making a judgment. In this regard, one member raised the following as situations that would require consideration of additional monetary policy responses: (1) a significant downward revision in the Bank's baseline scenario for economic activity and prices, or a heightening of downside risks; or (2) a decline in the functioning of financial markets. This member continued that additional responses were therefore not necessary at present, taking into account the current economic and financial situation. A different member said that the Program had brought about such positive effects as the narrowing of risk premiums and stabilization of long-term and short-term interest rates at low levels, even after the earthquake. Based on these perspectives, many members expressed the view that it would be appropriate to continue steadily conducting purchases of financial assets in line with the additional monetary easing measure decided after the earthquake, as well as continue monitoring how the effects of the easing were spreading.

A few members said that, in order to gain market participants' full understanding of the Bank's policy stance, it was necessary for the Bank to make use of various opportunities to continue communicating to the public that it was determined to maintain the virtually zero interest rate policy until it judged that price stability was in sight on the basis of the "understanding of medium- to long-term price stability."

With regard to <u>the new line of credit for the fund-provisioning measure to support strengthening the foundations for economic growth</u>, which the Bank decided to establish at the previous meeting, one member indicated that some regional financial institutions had said that they were willing to actively respond to local needs for funds, since eligible investments and loans mainly covered areas where there was less competition among financial institutions in providing loans to small businesses and venture firms. Meanwhile, a different member noted that some firms were concerned that the use of the asset-based lending (ABL) scheme might invite speculation about a shortage of commonly used collateral. Some members said that, in order to raise the degree of recognition of ABL in Japan, it was necessary for the Bank to continue making such efforts as devising ways to communicate more effectively to the public.

B. Extension of the Effective Period of the U.S. Dollar Funds-Supplying Operation against Pooled Collateral

Members discussed the extension of the effective period of the Bank's U.S. dollar funds-supplying operation against pooled collateral that had been explained by the staff. Some members said that there had been no particular concerns about Japanese financial institutions' U.S. dollar funding so far, and in fact, as evident in the results of the U.S. dollar funds-supplying operation, there had been no bids since August 2010. One member, however, noted that the possibility could not be denied that uncertainty about electric power supply and global concerns over developments at nuclear power plants in Japan, in addition to the sovereign debt problems in Europe, might affect Japanese financial institutions' funding in foreign currencies. Taking these views into consideration, most members said that, even though there had recently been no bidding in the Bank's operation, such a scheme for fund-provisioning in itself had a significant effect in reassuring market participants. In addition, some members expressed the view that, in a situation where global financial markets had not fully regained stability, a move by the Bank to take coordinated action with central banks in North America and Europe would be meaningful in terms of sending the message that central banks around the world were united in working toward achieving stability in the markets. Following this discussion, members agreed that it was appropriate for the Bank to extend the temporary U.S. dollar liquidity swap arrangement as proposed by the Federal Reserve Bank of New York, as well as the effective period of the U.S. dollar funds-supplying operation against pooled collateral, through August 1, 2012.

V. Remarks by Government Representatives

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

(1) The Japanese economy had been exhibiting signs of upward movement recently, although the situation remained severe due to the effects of the disaster. Due attention still needed to be paid to the downside risks to the economy stemming mainly from fluctuations in foreign exchange rates and a further slowing of recovery in overseas economies, in addition to electric power supply constraints and the effects of the ongoing problems at nuclear power plants and of high crude oil prices.

(2) The second supplementary budget for fiscal 2011 was decided by the Cabinet on July 5. The supplementary budget accommodated expenditures necessary to ensuring steps toward restoration for the immediate future. The government would manage to secure the financial resources for the supplementary budget mainly by allocating surpluses achieved in fiscal 2010, rather than issuing additional Japanese government bonds (JGBs). It would proceed with its efforts to submit the supplementary budget to the Diet at the earliest possible date in July. The government would aim to promptly obtain the Diet's approval, and work toward restoring and rebuilding the disaster areas.

(3) Regarding the comprehensive reform of social security and taxation, the Headquarters of the Government and Ruling Parties for Social Security Reform finalized the draft on June 30. The government deemed it extremely important, particularly in view of maintaining market confidence at home and abroad, to achieve fiscal consolidation while at the same time securing a stable supply of the necessary fiscal resources for social security reform. In addition, the government established the Headquarters for the Reconstruction from the Great East Japan Earthquake on June 24, and was proceeding with discussions on the specifics of measures toward full-scale rebuilding, based on the proposal by the Reconstruction Design Council in Response to the Great East Japan Earthquake. The government would continue to work swiftly and steadfastly in an effort to make progress toward restoration and rebuilding.

(4) The government expected the Bank to continue taking decisive monetary policy actions, considering the effects of the disaster on the economy and financial markets, the progress of rebuilding, and developments in overseas economies. It welcomed the Bank's extension of the effective period of the U.S. dollar funds-supplying operation against pooled collateral discussed at this meeting, which would form part of central banks' coordinated measures to ensure financial stability.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy had been exhibiting signs of upward movement recently, as seen in the steady restoration of supply chains and improvement in consumer sentiment. It was expected to pick up as production recovered against the background of, for example, a moderate recovery in overseas economies; however, due attention needed to be paid to the downside risks to the economy stemming mainly from a further slowing

of recovery in overseas economies, as well as from the effects of the ongoing problems at nuclear power plants.

(2) Although the year-on-year rate of increase in the CPI had been positive for the past two consecutive months, due attention needed to be paid to the possibility that the rate of change would be revised downward with the change in the base year for the CPI, scheduled to take place in August 2011. The economy was still in a mild deflationary situation, as evidenced, for example, by the continued fall in price trends. In this situation, close attention should be paid to the effects on economic activity of issues regarding the electric power supply system and of upward pressure on costs exerted by the sharp rise in energy prices in particular.

(3) With a view to achieving a prompt recovery from the disaster, the government would make efforts to swiftly obtain the Diet's approval of the second supplementary budget for fiscal 2011, and at the same time maintain and strengthen financial functions in the disaster areas. Furthermore, the government would formulate by the end of July a basic policy on reconstruction with the aim of supporting full-scale restoration and rebuilding of disaster areas, and also work toward restoring the growth potential of the Japanese economy based on the "Guideline on Policy Promotion." Regarding the comprehensive reform of social security and taxation, the government and ruling parties, having finalized the draft on June 30, would draw up concrete plans.

(4) The Bank's interim assessment of the April 2011 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. The government expected the Bank to continue steadily carrying out the funds-supplying operation to support financial institutions in disaster areas, in order to support restoration and rebuilding of the disaster areas from the financial side. It also hoped that the Bank would continue to underpin the economy through appropriate and flexible conduct of monetary policy while continuing to sufficiently exchange views and keep close contact with the government in order to overcome deflation.

VI. Votes

A. Vote on the Guideline for Money Market Operations

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, 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, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

Votes against the proposal: None.

B. Vote on "Amendment to 'Principal Terms and Conditions for U.S. Dollar Funds-Supplying Operations against Pooled Collateral'"

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

VII. Discussion on the Statement on Monetary Policy

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

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 13 and 14, 2011 for release on July 15, 2011.

Attachment

July 12, 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,[8] 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 economic activity is picking up with an easing of the supply-side constraints caused by the earthquake disaster. After declining sharply following the earthquake, production has recently shown clear signs of picking up with the easing of supply-side constraints. This has resulted in an upturn in exports. Domestic private demand has also begun to pick up, with some improvement in household and business sentiment. Meanwhile, financial conditions have generally continued to ease, albeit with the observed weakness in the financial positions of some firms, mainly small ones. The year-on-year rate of change in the CPI (excluding fresh food) has been slightly positive.

3. With supply-side constraints easing further and production regaining traction, Japan's economy is expected to return to a moderate recovery path from the second half of fiscal 2011, backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock. The

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

year-on-year rate of change in the CPI is expected to remain slightly positive.[9] Based on these assessments, Japan's economy is expected to return to a sustainable growth path with price stability in the longer run.

4. Compared with the forecasts presented in the April 2011 *Outlook for Economic Activity and Prices*, growth prospects will likely be somewhat lower for fiscal 2011 due to the sharp downturn immediately after the earthquake. Nevertheless, growth prospects for fiscal 2012 will likely remain broadly unchanged because the economy is expected to return to a moderate recovery path from the second half of 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 April forecasts.

5. Regarding risks to the economic outlook, although concern over supply chains has subsided, the impact of the earthquake disaster on Japan's economy, especially through changes in household sentiment, still requires due attention. Moreover, uncertainty has increased somewhat with regard to the longer-term outlook for electricity supply constraints. With regard to overseas economies, the effects of balance-sheet adjustments on the U.S. economy and the possible consequences of the sovereign risk problems in Europe continue to warrant attention. As for emerging and commodity-exporting economies, there is a high degree of uncertainty about the prospect of achieving price stability and economic growth at the same time. Regarding risks to the price outlook, inflation could rise more than expected if international commodity prices increase further, while there is also a possibility 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

[9] The year-on-year rate of change in the CPI is likely to be revised downward with the base-year change scheduled for August 2011.

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, including the effects of the disaster, and take appropriate policy actions as necessary.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2011	+0.2 to +0.6 [+0.4]	+2.2 to +2.5 [+2.4]	+0.6 to +0.8 [+0.7]
Forecasts made in April 2011	+0.5 to +0.9 [+0.6]	+1.6 to +2.6 [+2.2]	+0.5 to +0.8 [+0.7]
Fiscal 2012	+2.5 to +3.0 [+2.9]	+0.5 to +0.9 [+0.6]	+0.6 to +0.7 [+0.7]
Forecasts made in April 2011	+2.7 to +3.0 [+2.9]	+0.3 to +0.7 [+0.6]	+0.5 to +0.7 [+0.7]

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 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.

5. The ranges shown below include the forecasts of all Policy Board members.

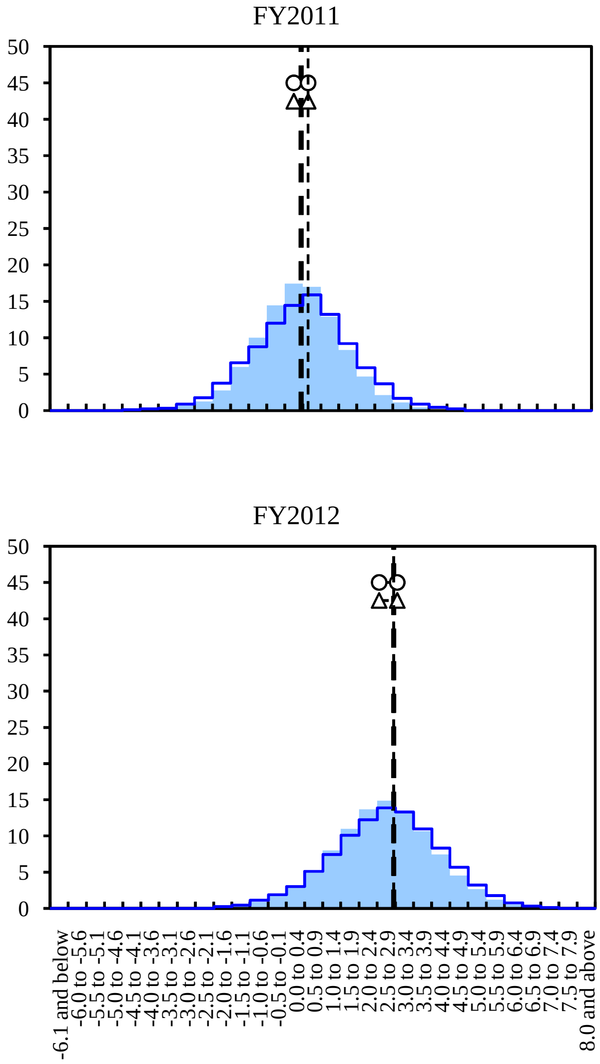
y/y % chg.

	Real GDP	Domestic CGPI	CPI (excluding fresh food)
Fiscal 2011	+0.2 to +0.6	+2.2 to +2.6	+0.5 to +0.8
Forecasts made in April 2011	+0.5 to +1.0	+1.5 to +2.7	+0.5 to +0.9
Fiscal 2012	+2.5 to +3.0	+0.3 to +1.0	+0.4 to +0.8
Forecasts made in April 2011	+2.5 to +3.0	+0.1 to +1.0	+0.4 to +0.7

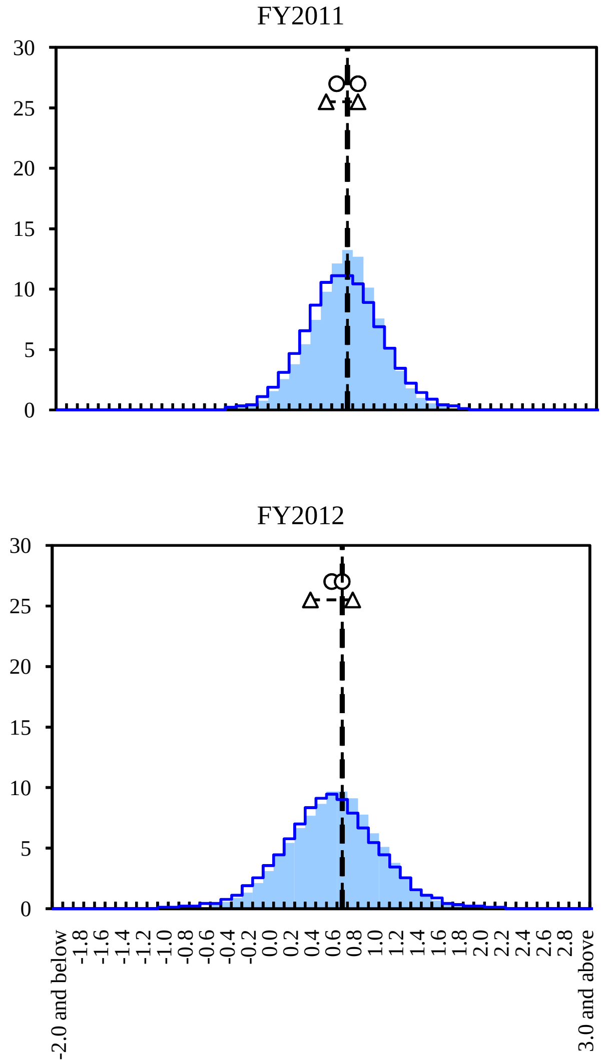
Appendix 2

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 2011, and solid lines represent those in April 2011.

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 2011.

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.*