Not to be released until 8:50 a.m. Japan Standard Time on Wednesday, June 20, 2012.

June 20, 2012

Bank of Japan

# Minutes of the Monetary Policy Meeting

## on May 22 and 23, 2012

(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 Tuesday, May 22, 2012, from 2:00 p.m. to 4:25 p.m., and on Wednesday, May 23, from 9:00 a.m. to 11:32 a.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. R. Miyao**
**Mr. Y. Morimoto**
**Ms. S. Shirai**
**Mr. K. Ishida**

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance[2]
Mr. S. Sato, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]
Mr. K. Ishida, Senior Vice Minister, Cabinet Office[2]
Mr. K. Matsuyama, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. H. Nakaso, Executive Director (Assistant Governor)
Mr. H. Hayakawa, Executive Director
Mr. N. Kinoshita, Executive Director[4]
Mr. K. Momma, Executive Director
Mr. S. Uchida, Director-General, Monetary Affairs Department

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on June 14 and 15, 2012 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.
[2] Messrs. Y. Fujita and K. Ishida were present on May 23.
[3] Messrs. S. Sato and K. Matsuyama were present on May 22.
[4] Mr. N. Kinoshita was present on May 22.

Mr. K. Kamiyama, 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. T. Kawamoto, Senior Economist, Monetary Affairs Department

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

## I. Summary of Staff Reports on Economic and Financial Developments[5]

### A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on April 27, 2012, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[6] In this situation, the uncollateralized overnight call rate had been in the range of 0.075 to 0.090 percent.

The sense of an abundance of liquidity continued to be strong in the money market, and yields on government bonds with short- to medium-term maturities had declined further, affected by the recent flight to quality. Under such circumstances, undersubscription had occurred in the fixed-rate funds-supplying operation against pooled collateral with a six-month term and the outright purchases of treasury discount bills (T-Bills) and Japanese government bonds (JGBs) under the Asset Purchase Program (hereafter the Program), and also in the regular purchases of JGBs to meet an increase in banknote demand.

### B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been stable at low levels. General collateral (GC) repo rates had been at around 0.1 percent. As for interest rates on term instruments, yields on T-Bills, including those with longer maturities, had been stable at around 0.1 percent. Rates on longer-term interbank instruments had been more or less unchanged.

Amid the global heightening of risk aversion among investors caused by concern over the European debt problem, the benchmark long-term interest rate had declined to around 0.85 percent and the Nikkei 225 Stock Average dropped to the range of 8,500-9,000 yen. Prices for Japan real estate investment trusts (J-REITs) had also declined. Yield spreads between corporate bonds and JGBs continued to be more or less unchanged on the whole, reflecting solid demand from investors for corporate bonds. The yen had been at around 80 yen against the U.S. dollar, basically the same level as the previous month.

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

[6] The guideline was as follows:

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

## C. Overseas Economic and Financial Developments

Overseas economies on the whole still had not emerged from a deceleration phase, but some improvement had been observed.

The U.S. economy continued to recover at a moderate pace. Private consumption was increasing, reflecting a modest improvement in the employment situation, but the pace of recovery was generally moderate partly because the balance-sheet repair continued to weigh on the economy. Housing investment remained at a depressed level with weakness in housing prices. On the other hand, exports continued to gain momentum, and business fixed investment maintained its uptrend. Under these circumstances, production continued to increase moderately. As for prices, while slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, the year-on-year rate of increase in the consumer price index (CPI) for all items decelerated, partly due to a gradual decline in energy prices, such as those of gasoline, and to the dissipating effects of the significant rise in energy prices a year earlier. The year-on-year rate of increase in the CPI for all items less food and energy, or the core CPI, had been in the range of 2.0-2.5 percent as the shelter index continued to rise moderately.

Economic activity in the euro area had been sluggish. Signs of a pick-up in exports were seen mainly in those to the United States and emerging economies. On the other hand, business fixed investment had been declining, and private consumption was more or less unchanged. Household and business sentiment remained weak in some peripheral countries, but showed signs of a pick-up mainly in Germany and France. Under these circumstances, production was declining but the pace of decline had moderated somewhat. As for prices, although slack in supply and demand conditions was exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items remained at a relatively high level due mainly to the effects of the earlier rise in energy prices, such as those of gasoline. Meanwhile, economic activity in the United Kingdom had been sluggish as well.

With regard to Asia, the Chinese economy continued to show relatively high growth, although the pace had slowed somewhat. The rate of increase in exports was slowing. In terms of domestic demand, the rates of increase in fixed asset investment and private consumption had decelerated to some extent, although they remained at relatively high levels. These slowdowns resulted from the deceleration in private real estate investment for the former and slower growth in the consumption of durable goods such as electrical appliances for the latter. Nevertheless, a favorable employment and income situation and a declining trend in inflation rates were underpinning private consumption. Given such developments in demand, the rate of increase in production was decelerating to some extent. Regarding the NIEs and the ASEAN countries, the pace of economic growth had begun to pick up. As for domestic demand, business fixed investment had been increasing moderately and private consumption had been firm. Exports and production were picking up, reflecting the restoration following the damage caused by the flooding in Thailand, but the pace of the pick-up remained only moderate. As for prices, in many of the NIEs and the ASEAN economies, core inflation rates were at relatively high levels, mainly reflecting the higher wage inflation caused by tight labor market conditions. On the other hand, inflation rates for all items had fallen at a moderate pace, due mainly to a halt in the surge in food prices. In India, the deceleration of economic growth had come to a halt.

In global financial markets, some nervousness had recently been seen amid the heightening of risk aversion among global investors, mainly reflecting concern over the European debt problem. The yield spreads of government bonds issued by European countries over German government bonds had been widening for Greece and Spain in particular, on the back of the political turmoil in Greece and deepening concern about banks' impaired assets in Spain. U.S. and European stock prices had been declining substantially, and long-term interest rates in the United States and Germany had declined to historically low levels due to the heightening of demand for safe assets. With regard to corporate bond markets in the United States and Europe, credit spreads on corporate bonds had been widening somewhat, particularly in the financial sectors of some peripheral European countries. Stock prices and currencies in emerging and commodity-exporting economies had been declining considerably, particularly in Russia, Brazil, and Australia, due in part to weakness in international commodity prices. Regardless of these developments, the funding conditions of European financial institutions had been stable on the whole, due in part to the various measures taken by central banks so far. Spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates had been more or less unchanged. With regard to U.S. dollar funding conditions, spreads between interest rates on U.S. dollar-denominated term instruments and

OIS rates had been more or less unchanged, and the U.S. dollar funding premium in the foreign exchange swap markets had also been essentially flat. Nevertheless, interest rates futures, which indicated the outlook for interest rates on U.S. dollar-denominated term instruments, as well as the U.S. dollar funding premium in the longer-term basis swaps, had recently been on an increasing trend.

## D. Economic and Financial Developments in Japan

1. Economic developments

Exports so far remained more or less flat. They were expected to gradually emerge from the current phase of flat growth and increase moderately, mainly reflecting a pick-up in the pace of recovery in overseas economies.

Public investment had been increasing. Public investment in real terms, based on the GDP statistics, and the amount of public construction completed -- both of which reflected the progress of public works -- increased in the January-March quarter of 2012 on a quarter-on-quarter basis. Looking ahead, public investment was expected to be on the rise, mainly due to the restoration of damaged social capital. The value of public works contracted -- a measure that reflected public works orders -- had risen in the January-March quarter on a quarter-on-quarter basis, and also registered an increase in April relative to that quarter.

Business fixed investment had been on a moderate increasing trend with some improvement in business sentiment. It was expected to continue on this uptrend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities as well as to strengthen earthquake resistance and business continuity systems, as corporate profits improved gradually.

The employment and income situation continued to be severe, although there were signs of improvement.

Against the background of improvement in consumer sentiment, private consumption had been increasing moderately due to the effects of measures to stimulate demand for automobiles. On a GDP basis, real private consumption registered relatively high growth in the January-March quarter of 2012 from the previous quarter, after having increased for three consecutive quarters. Private consumption was expected to remain firm as the employment situation gradually headed toward improvement.

Housing investment had generally been picking up and was expected to continue to do so, mainly due to the reconstruction of disaster-stricken homes.

Production, while remaining more or less flat, had shown some signs of picking up. It was expected to increase moderately as domestic demand stayed firm and as exports picked up gradually. Although the production forecast index suggested a decline in May 2012, production showed some signs of picking up in the months ahead, as evidenced by the fact that (1) the shipment-inventory balance, especially in electronic parts and devices, had improved gradually; and (2) according to interviews with firms, many of them expected production to register a marginal increase in the April-June quarter of 2012.

As for prices, international commodity prices had been falling back slightly within their high ranges. The three-month rate of increase in the domestic corporate goods price index (CGPI) was rising moderately, mainly due to the earlier increase in international commodity prices. The CGPI was expected to increase at a reduced pace for the time being, mainly reflecting movements in international commodity prices. The year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and was expected to stay at this level for the time being.

## 2. Financial environment

Financial conditions continued to ease.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. 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 also remained favorable on the whole. As for credit demand, firms showed signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of change in the amount outstanding of bank lending had been positive. The year-on-year rate of change in the total amount outstanding of corporate bonds and CP had been moving around 0 percent, while that of corporate bonds had been slightly negative. In these circumstances, firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock had been positive at around 2.5 percent.

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

### A. Economic Developments

In terms of global financial markets, members agreed that some nervousness had recently been seen mainly due to concern about the European debt problem, and therefore close attention should be paid to developments in these markets for the time being. Many members noted that, once again, yields on government bonds issued by some peripheral European countries had risen and credit spreads of bank debentures and credit default swap (CDS) premiums for European financial institutions had been widening on the back of concern about the political situation in Greece and banks' impaired assets in Spain. While noting that uncertainty regarding the outlook for the global economy was increasing somewhat, triggered by the European debt problem, many members said that risk aversion among investors was heightening and consequently causing considerable declines in stock prices and weakness in international commodity prices -- mainly crude oil prices. A few members commented that the considerable declines in stock prices and currencies in emerging and commodity-exporting economies were attributable to the heightened risk aversion and a fall in international commodity prices. Meanwhile, most members noted that, due to investors' preference for safe assets, long-term interest rates in Japan, the United States, and Germany had declined further, and that the yen and the U.S. dollar had been appreciating in the foreign exchange market. Some of these members commented that, as background to the further declines in long-term interest rates, cautious views regarding the outlook for economic activity and prices, as well as powerful monetary easing measures such as the purchases of government bonds conducted by central banks, were exerting non-negligible influence. Some members noted that, in view of ensuring the stability of the financial system, interbank funding markets needed to be stable. On this basis, these members said that, although funding markets were generally stable at present, mainly due to the effects of the provision of a large amount of funds by the European Central Bank (ECB), some developments warranted attention, such as an increasing trend in the U.S. dollar funding premium in the longer-term basis swaps and the continued outflow of deposits from Greek banks. In this situation, members shared the view that it was necessary for governments and relevant authorities in their respective countries to proceed with fiscal and economic structural reforms, bearing firmly in mind that measures such as the provision of a large amount of funds were policies that could only be used to buy time. Some members noted that such reforms involved political difficulties and therefore would not proceed without hindrance.

Members concurred that overseas economies on the whole still had not emerged from a deceleration phase, but some improvement had been observed, including the continued recovery, albeit at a moderate pace, of the U.S. economy. As for the outlook, they shared the view that the pace of growth was likely to pick up, led by emerging and commodity-exporting economies.

With regard to the U.S. economy, members agreed that business fixed investment maintained its uptrend, supported by firming exports, and private consumption was also increasing moderately. They also agreed that the economy was likely to continue to recover at a moderate pace. Some members said that a modest improving trend in the employment situation continued as a whole, although the effects of the boost from a record-breaking warm winter were starting to dissipate somewhat. Regarding adjustments in households' balance sheets, a few members noted that some positive developments had been observed compared with the past. These members pointed out that households' debt relative to income was decreasing moderately, although it remained at a high level, and that the interest burden was waning. In relation to this point, a few other members added that it would take more time for balance-sheet adjustments to be completed given that (1) even if their debts declined as a result of debt restructuring, households would still face difficulties in applying for new loans that would lead to an increase in spending; and (2) housing prices continued to be weak.

As for the economic activity in the euro area, members agreed that it had been sluggish despite signs of a pick-up in exports, because domestic demand in the area had been stagnant and acted as a drag on economic activity. They continued that the economy was likely to remain sluggish for the time being, mainly on the back of continuing fiscal austerity and relatively tight financial conditions. Some members noted that, while the German economy had been firm, as seen in the fact that the unemployment rate had registered a historically low level since the reunification of East and West Germany, a deterioration in economic sentiment continued in Italy and Spain due to the severe credit conditions and continuing fiscal austerity, and continued that disparities among countries regarding economic sentiment were widening further. Some members were of the view that European governments facing debt problems were confronted with a critical challenge of simultaneously achieving the medium- to long-term task of fiscal consolidation and structural reforms and promoting short-term economic growth.

Regarding the Chinese economy, most members expressed the view that the rate of increase in exports, especially to Europe, was slowing and -- due in part to the effects of the earlier monetary tightening -- the rates of increase in durable goods consumption and private real estate investment had decelerated to some extent. These members continued, however, that the employment and income situation was favorable and, although the pace of economic growth had slowed somewhat, the economy as a whole continued to show relatively high growth, led mainly by domestic demand. Some members noted that the slower increases in electricity production and consumption, freight transport volume, and tax revenues for April 2012 were signs that the pace of Chinese economic growth continued to slow. As for the outlook, members shared the view that the growth rate of the economy would increase gradually as a decline in inflation rates and a favorable employment and income situation were likely to underpin private consumption, although the slower growth in fixed asset investment, primarily real estate investment, could become prolonged. With regard to price developments, a few members noted that the Chinese authorities had not embarked on decisive monetary easing despite the clear decline in inflation rates, and pointed out that this might be because the authorities believed that inflationary pressure did persist. Against this view, some members said that recent remarks by the officials suggested their clearer stance toward supporting economic activity. A few members added that, although there was no evidence that the growth potential of the Chinese economy was declining, attention should be paid to the possibility that the effects of monetary easing had become less pronounced than before, as substantiated by the fact that an increase in bank lending had been less evident these days despite the easing of the authorities' guidance toward banks.

With regard to emerging and commodity-exporting economies including China, members shared the view that the pace of growth in these economies as a whole was no longer on a decelerating trend. As for the outlook, they continued that the growth rates of these economies would increase as the virtuous circle of production, income, and spending was likely to gradually strengthen.

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

Regarding recent developments in the economy, members agreed that it had become increasingly evident that Japan's economy was shifting toward a pick-up phase, although its economic activity had remained more or less flat. They shared the recognition that exports so far remained more or less flat. Members concurred that public investment had been increasing with the progress in the execution of the budget related to the earthquake disaster, and business fixed investment had been on a moderate increasing trend with some improvement in business sentiment as firms projected profit improvements. They shared the recognition that, against the background of improvement in consumer sentiment, private consumption had been increasing moderately due to the effects of measures to stimulate demand for automobiles. With regard to the fact that real private consumption on a GDP basis had registered relatively high growth in the January-March quarter of 2012, a few members said that this was mainly attributable to the effects of the leap year and subsidies for purchasers of environmentally friendly cars. However, these members continued that it was noteworthy that the growth in consumption in the January-March quarter represented a fourth consecutive quarterly increase, and that categories of consumption other than durable goods had marked relatively high growth. Members shared the view that production, while remaining more or less flat, had shown some signs of picking up.

As for the outlook for the economy, members agreed that it was likely to return to a moderate recovery path as the pace of recovery in overseas economies picked up, led by emerging and commodity-exporting economies, and as reconstruction-related demand after the earthquake disaster gradually strengthened. They shared the view that exports and production were likely to gradually emerge from the current phase of flat growth and recover moderately. On this basis, many members said that, while overseas demand could remain somewhat weak, domestic demand, especially post-earthquake reconstruction-related demand and private consumption, would likely stay firm for some time. One member commented that autonomous movements, in addition to the effects of policy measures, had started to support private consumption. This member continued that, for example, a move to delay summer discount sales in the department store industry was a positive phenomenon that had been observed for the first time in recent years. A different member said that private consumption remained firm mainly due to the following factors: (1) pent-up demand following the earthquake disaster and demand related to the rebuilding of daily lives in the disaster areas; (2) the effects of policy measures such as subsidies for purchasers of environmentally friendly cars; and (3) firms' efforts to explore new sources of demand from the elderly. This member added that the effects of the first and second factors were likely to wane, and there was considerable uncertainty regarding the quantitative impact and sustainability of the third factor.

With regard to risks to the outlook for Japan's economy, members concurred that there remained a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy amid lingering strains from balance-sheet adjustments, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. Regarding the European debt problem, they shared the view that the tail risk that disturbances in global financial markets would cause a significant downturn in the global economy had waned compared to around the end of 2011. They continued, however, that the European debt problem was a risk that should be of the most concern given the heightening uncertainty over the situation surrounding fiscal and economic structural reforms in European countries. On this basis, a few members said that the risk of the European debt problem having a global adverse effect through the financial channel could not be ruled out, depending on how the problem would be resolved, and that it was therefore necessary to pay due attention to how the European situation would play out. One member expressed concern over the impact of the recent appreciation of the yen and fall in stock prices -- both stemming from the European debt problem -- on domestic business fixed investment, mainly resulting from changes in business sentiment. Some members added that, if the pace of growth in the Chinese economy were to decelerate noticeably as a result of, for example, the decrease in exports to Europe, then this would affect the Bank's economic outlook presented in the April 2012 *Outlook for Economic Activity and Prices*, which assumed a rise in overseas economic growth, although such a scenario would still depend on the prospects for the U.S. economy. A few members pointed to the uncertainty regarding electric power supply for this summer as a risk factor unique to Japan's economy.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and likely to stay at this level for the time being. Some members highlighted the following as recent changes in the price situation: (1) there were signs that firms were regaining their pricing power as a result of the restructuring of industries; and (2) there was a shift, mainly by convenience stores, to more value-added activities in response to changes in the demand structure due to the aging of the population. With regard to the fact that the domestic demand deflator for the January-March quarter of 2012 had turned positive on a quarter-on-quarter basis, a few members commented that it was notable that steady improvement had been observed across a wide range of demand components, such as consumption and business fixed investment. A few members said that it was important for the Bank to explain in detail such positive developments in the current price situation with a view to preventing deflationary expectations from intensifying.

With regard to risks to the outlook for prices, members shared the recognition that careful attention should be paid to future developments in international commodity prices and in medium- to long-term inflation expectations. A few members said that, if international commodity prices continued to follow the current downtrend, this could cause a weakening in prices. One of these members, noting that short-term inflation expectations remained at a low level, expressed the opinion that careful attention should be paid to such developments, since they could lead to a slowdown in the pace at which the rate of inflation converged with the level considered stable from a medium- to long-term perspective -- that is, the inflation anchor. A different member added that it was necessary to pay attention to the risk that crude oil prices might rise depending on developments in the Middle East.

### B. Financial Developments

Members agreed that financial conditions in Japan continued to ease.

Members agreed that the money market had been extremely stable, as the Bank had been pursuing powerful monetary easing and the soundness of financial institutions' balance sheets had been maintained. They shared the view that issuing conditions for CP remained favorable, as did those for corporate bonds on the whole. They were of the view that firms' funding costs had declined moderately, and that the availability of funds, including the funding conditions of small firms, remained on an improving trend. While the year-on-year rate of increase in the amount outstanding of bank lending had declined, a few members explained that this was because the positive contribution from large-scale loans that were extended after the earthquake disaster a year ago had dissipated. These members continued that credit demand, mainly for working capital and funds related to mergers and acquisitions, remained on an increasing trend.

### 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 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.

In relation to monetary policy for the immediate future, members shared the view that Japan's economy faced the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. They continued that, based on the recognition that this challenge would be met through efforts to strengthen the economy's growth potential and support from the financial side, the Bank had been pursuing powerful monetary easing and providing support to strengthen the foundations for economic growth. They agreed that the Bank would continue to conduct policy in an appropriate manner. A few members raised the possibility that Japan's economy would be adversely affected if a substantial risk materialized, stemming from the European debt problem. These members commented that the Bank should therefore stand ready to take appropriate actions without ruling out any options in advance. One member noted the following points: (1) Japan's deflation was influenced by structural factors; and (2) the effects of monetary policy were transmitted with a considerable lag. This member was of the view that, if the Bank overlooked these points and proceeded with further monetary easing by automatically responding only to short-term price developments, there was a risk that the stability in economic activity and prices in the medium to long term would be jeopardized should unexpected events occur in financial markets.

Members shared the view that, given that the Bank was pursuing powerful monetary easing in a severe fiscal situation, it was extremely important that the credibility of fiscal sustainability in financial markets be maintained to ensure the effectiveness of monetary policy transmission, as well as the stability of the financial system and sustainable growth of Japan's economy. Some members, noting that long-term interest rates had declined further, said that attention needed to be paid to a risk of an abrupt jump in these rates, which could be triggered by future events. One of these members commented that the effects of monetary easing would be curtailed if a rise in longer-term interest rates adversely affected the financial conditions of financial institutions.

In terms of the Program, members agreed that, at this point, it was appropriate to steadily implement the purchases of financial assets under the Program, which was expanded as a result of the decision made at the April 27 meeting, and to monitor the effects of these purchases. One member said that, given that market participants and the mass media were paying particular attention to whether the Bank would increase the total size of the Program, it was important for the Bank to explain more thoroughly that proceeding with asset purchases within the current total size of the Program would still enhance monetary easing.

As for the undersubscription that occurred in the Bank's JGB purchases, members shared the view that this indicated that the effects of the Bank's powerful monetary easing had been permeating the financial markets. A few members added that undersubscription was expected to occur if the Bank conducted further large-scale asset purchases and provided a large amount of funds. These members continued that, given that undersubscription might be possible, the Bank decided at the April 27 meeting to extend the remaining maturity of JGBs and corporate bonds to be purchased under the Program from "one to two years" to "one to three years," and to reduce the maximum outstanding amount of the fixed-rate funds-supplying operation against pooled collateral. Many members, including these members, expressed the view that it was necessary for the operation desk to make the operational adjustment required for completing the asset purchases under the Program.

## IV. Remarks by Government Representatives

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

(1) The Japanese economy was on the way to recovery at a moderate pace, reflecting emerging demand for reconstruction. As for the outlook, movement toward sound recovery was expected to take hold. However, the government was seriously concerned about the downside risks to the Japanese economy that could stem from

sharp fluctuations in the financial markets and the further slowdowns in overseas economies as concern over the European debt problem heightened.

(2) The government was currently making its best efforts to work on the comprehensive reform of the social security and taxation systems, in order to secure stable financial resources for social security functions and at the same time achieve fiscal consolidation. It would continue to do its utmost to promptly obtain the Diet's approval of related bills, including those recently being deliberated in the Diet for the fundamental reform of the tax system, which primarily aimed to secure stable financial resources for social security functions and contained provisions to raise the consumption tax rate in a phased manner.

(3) The government and the Bank shared the view that overcoming deflation was the top-priority task in Japan. At the Council for the Promotion of Growth and Finance held recently, the government, with the aim of strengthening growth potential, compiled the mid-term report on the set of measures to expand the supply of growth money -- that is, funds that would lead to economic growth. The government would delve deeper into discussions to formulate the "Strategy for Rebirth of Japan" that would be drawn up at midyear.

(4) The government and the Bank had been making policy efforts while sufficiently exchanging views and keeping close contact, but Japan had not yet overcome deflation. The government expected the Bank -- under its policy stance that, for the time being, it would pursue powerful monetary easing with the aim of achieving the goal of 1 percent in terms of the year-on-year rate of increase in the CPI, and continue to do so until it judged the 1 percent goal to be in sight -- to conduct monetary policy vigorously and decisively while continuing to closely monitor developments in financial markets at home and abroad, as well as work sufficiently on its communication -- including the dissemination of information -- to the public in an effort to make its policy stance fully understood.

The representative from the Cabinet Office made the following remarks.

(1) The first preliminary estimate of real GDP for the January-March quarter of 2012 indicated a relatively high rate of growth, at 4.1 percent on an annualized basis. This was primarily attributable to the growth in domestic demand that had been supported by

emerging demand for reconstruction and the effects of policy measures such as subsidies for purchasers of environmentally friendly cars, and to the pick-up in exports brought about by the rebound from the plunge caused by the effects of the flooding in Thailand and the recovery of the U.S. economy. A solid income environment seemed to be underpinning the increase in consumption.

(2) The Japanese economy was on the way to recovery at a moderate pace, reflecting emerging demand for reconstruction. As for the outlook, movement toward sound recovery was expected to take hold, reflecting the effects of a range of policy measures. However, there was growing uncertainty about the prospects for the European sovereign debt crisis, for example, and thus downside risks to the economy required strong vigilance.

(3) Although the rate of decline in prices was moderating recently, the Japanese economy remained in a mild deflationary situation. In order to overcome deflation -- a challenge Japan had confronted for over a decade -- it was important to address the structural problem that tended to generate deflation, while simultaneously working on macroeconomic management. To this end, at the ministerial-level Council on the Economic Situation including the Issue of Overcoming Deflation, the government, with the aim of overcoming deflation and stimulating economic activity, was holding active discussions on the basic policy direction and policy areas to be considered -- in view of, for example, changes in the economic phases -- while remaining particularly aware of the economic situation through fiscal 2013.

(4) The government expected the Bank to continue to make its utmost efforts in the conduct of monetary policy in parallel with the government measures, taking account of the downside risks to the outlook for the Japanese economy. Specifically, the government deemed it particularly important to produce visible results by achieving as promptly as possible an inflation rate of 1 percent, the rate the Bank aimed to achieve for the time being in terms of the year-on-year rate of increase in the CPI. In order to do so, the government expected the Bank to conduct monetary policy flexibly and decisively.

## 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, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

Votes against the proposal: None.

## VI. 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).

## VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of April 27, 2012 for release on May 28, 2012.

Attachment

May 23, 2012

Bank of Japan

**Statement on Monetary Policy**

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote, to set the following guideline for money market operations for the intermeeting period:

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

2. Overseas economies on the whole still have not emerged from a deceleration phase, but some improvement has been observed, including the continued recovery, albeit at a moderate pace, of the U.S. economy. In global financial markets, some nervousness has recently been seen, mainly due to concern about the European debt problem. Close attention should therefore be paid to developments in these markets for the time being.

3. It has become increasingly evident that Japan's economy is shifting toward a pick-up phase, although its economic activity has remained more or less flat. Exports have so far remained more or less flat. As for domestic demand, public investment has been increasing. Business fixed investment has been on a moderate increasing trend with some improvement in business sentiment. Against the background of improvement in consumer sentiment, private consumption has been increasing moderately due to the effects of measures to stimulate demand for automobiles. Housing investment has generally been picking up. Production has shown some signs of picking up reflecting these developments in demand at home and abroad, although it has remained more or

less flat. Meanwhile, financial conditions in Japan have continued to ease. On the price front, the year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent.

4. As for the outlook, Japan's economy is expected to return to a moderate recovery path as the pace of recovery in overseas economies picks up, led by emerging and commodity-exporting economies, and as reconstruction-related demand after the earthquake disaster gradually strengthens. The year-on-year rate of change in the CPI is expected to remain at around 0 percent for the time being.

5. Regarding risks to the economic outlook, there remains a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. Regarding risks to the price outlook, careful attention should be paid to future developments in international commodity prices and in medium- to long-term inflation expectations.

6. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. This challenge will be met through efforts to strengthen the economy's growth potential and support from the financial side. The Bank continues to conduct policy in an appropriate manner.