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September 24, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on August 8 and 9, 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 Wednesday, August 8, 2012, from 2:00 p.m. to 4:57 p.m., and on Thursday, August 9, from 8:59 a.m. to 12:14 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. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Mr. T. Sato

Mr. T. Kiuchi

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

Mr. K. Momma, 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 September 18 and 19, 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 August 9.

[3] Messrs. S. Sato and K. Matsuyama were present on August 8.

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

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. K. Kamada, Head of Economic Research Division, Research and Statistics Department

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

Secretariat of the Monetary Policy Meeting

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

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

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

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

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

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on July 11 and 12, 2012, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[5] In this situation, the uncollateralized overnight call rate had been in the range of 0.080 to 0.095 percent.

With regard to the operation of the Asset Purchase Program (hereafter the Program), bidding activity for the Bank's outright purchases of treasury discount bills (T-Bills) had clearly recovered as a result of measures, decided at the previous meeting, that were aimed at steadily increasing the amount outstanding of the Program.[6] As for the Bank's fixed-rate funds-supplying operation against pooled collateral (hereafter the fixed-rate operation), undersubscription -- that is, aggregate bids falling short of the Bank's offers -- continued to occur in the fixed-rate operation with a 6-month term. However, there was a sufficient amount of bids in the operation with a 3-month term. In a situation where yields on Japanese government bonds (JGBs) had declined to extremely low levels, undersubscription had occurred in the Bank's outright purchases of JGBs on August 1, 2012, for the first time in two and a half months.

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

[5] The guideline was as follows:

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

[6] At the previous meeting on July 11 and 12, 2012, in response to the fact that undersubscription had been occurring on a continuous basis in the Bank's fixed-rate funds-supplying operation against pooled collateral and some other purchases, the Policy Board decided to adopt the following measures, with a view to proceeding with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program: (1) a reduction in the maximum outstanding amount of the fixed-rate funds-supplying operation against pooled collateral of about 5 trillion yen and an increase in the outright purchases of T-Bills of about 5 trillion yen; (2) the removal of the minimum bidding yield (currently 0.1 percent per annum) for outright purchases of T-Bills and CP in order to ensure their smooth purchase; and (3) the integration of loan durations (currently "3 months" or "6 months") into "within 6 months" under the fixed-rate funds-supplying operation against pooled collateral in order to respond flexibly to liquidity demand by financial institutions.

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. Issuance rates on T-Bills, meanwhile, had been marginally below 0.1 percent. Rates on longer-term interbank instruments had declined very slightly.

With regard to long-term interest rates, yields on 2-year JGBs had been more or less flat at around 0.1 percent, but had recently fallen below 0.1 percent. Yields on 10-year JGBs temporarily declined to 0.70-0.75 percent amid the substantial drops in U.S. long-term interest rates due to concern over the European debt problem and uncertainty about the outlook for the U.S. economy. They subsequently rose somewhat, reflecting expectations for policy actions by the European authorities, and had recently been at 0.75-0.80 percent -- the same level as at the time of the previous meeting. The Nikkei 225 Stock Average had been fluctuating in reflection of developments in the European debt problem, and had recently been in the range of 8,500-9,000 yen -- the same level as at the time of the previous meeting. Prices for Japan real estate investment trusts (J-REITs) had been rising somewhat, albeit with fluctuations. 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 temporarily appreciated to the 77-78 yen range against the U.S. dollar, and to the 94-95 yen range against the euro -- the latter representing the highest level since November 2000 -- mainly due to concern over the European debt problem and expectations for monetary easing in the United States. It subsequently depreciated, however, and had recently been in the ranges of 78-79 yen against the U.S. dollar and 97-98 yen against the euro.

C. Overseas Economic and Financial Developments

Overseas economies had shown moderate improvement, though limited in scope; on the whole, they still had not emerged from a deceleration phase.

The U.S. economy generally continued to recover at a moderate pace, although signs of weakness were observed, such as in business sentiment. Private consumption was increasing, reflecting a modest improving trend 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, although home sales showed some signs of a pick-up. In the corporate sector, the momentum of growth in exports slowed somewhat, and some indicators for business sentiment declined. Nevertheless, business fixed investment maintained its uptrend and production also 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 due to a gradual decline in energy prices, such as those of gasoline.

Economic activity in the euro area had been sluggish. Growth in exports was slow. As for domestic demand, business fixed investment had been declining and private consumption was more or less unchanged. Furthermore, the weakening of household and business sentiment was spreading from peripheral countries to core countries. Under these circumstances, production was declining. As for prices, in a situation where 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 decelerated somewhat, partly reflecting the decline in gasoline prices. Meanwhile, economic activity in the United Kingdom had been sluggish as well.

With regard to Asia, although the Chinese economy continued to show relatively high growth, the pace of economic growth was slowing. The rates of increase in fixed asset investment and private consumption had decelerated, although they remained at relatively high levels. These slowdowns resulted from the deceleration in private real estate investment for the former and in the consumption of durable goods such as electrical appliances for the latter. Given such developments, the rate of increase in production was decelerating due in part to inventory adjustments. Nevertheless, some signs of improvement were observed recently, such as an increase in infrastructure investment and an uptick in real estate sales. 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 generally been increasing moderately and private consumption had been firm. The momentum of growth in exports and production had recently slowed rather significantly, mainly due to sluggish growth in exports to Europe and China, and business sentiment had become cautious. As for prices, in many of the NIEs and the ASEAN countries, there was still upward pressure on prices, mainly reflecting the wage inflation caused by tight labor market conditions, but inflation rates had been declining moderately mainly due to a halt in the surge in food prices and a decline in energy prices. In India, the deceleration of economic growth had come to a halt.

In global financial markets, some nervousness continued to be seen, mainly reflecting concern over the European debt problem. Various actions continued to be taken by European governments and the European Central Bank (ECB), but the content and swiftness of these actions had not been enough to earn a positive response from the market. In this situation, yield spreads of Spanish and Italian government bonds over German government bonds remained at high levels. U.S. and European stock prices had been rising slightly, albeit with fluctuations, mainly reflecting expectations for policy actions. Long-term interest rates in the United States and Germany had been declining to some extent since the previous meeting, in reflection of heightening demand for safe assets and expectations for policy actions. With regard to corporate bond markets in the United States and Europe, credit spreads on corporate bonds had been flat. Stock prices and currencies in emerging and commodity-exporting economies had been more or less unchanged on the whole. The funding conditions of European financial institutions continued to be stable on the whole. Spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates had narrowed somewhat as the ECB cut policy interest rates. The U.S. dollar funding premium in the foreign exchange swap markets had also declined somewhat while spreads between interest rates on U.S. dollar-denominated term instruments and OIS rates were generally unchanged.

D. Economic and Financial Developments in Japan

1. Economic developments

The pick-up in exports had moderated. Although real exports, for the first time in three quarters, had risen in the April-June quarter of 2012 on a quarter-on-quarter basis, monthly figures showed that they had declined for two straight months in May and June after having risen in April. Exports were expected to increase moderately as overseas economies emerged from the deceleration phase.

Public investment continued to increase, primarily in that related to reconstruction following the earthquake disaster. The amount of public construction completed -- a measure that reflected the progress of public works -- continued to rise in the April-May period relative to the January-March quarter, after having registered a quarter-on-quarter increase in that quarter. The value of public works contracted -- a measure that reflected public works orders -- had also increased significantly in the April-June quarter on a quarter-on-quarter basis, after having risen in the January-March quarter. Against this background, public investment was expected to be on the rise.

Business fixed investment had been on a moderate increasing trend with improvement in corporate profits. 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 kept improving.

The employment and income situation, although it remained severe, had generally been improving, as evidenced partly by the fact that (1) the ratio of job offers to applicants continued to improve and (2) the unemployment rate had been trending downward.

Against the background of improvement in consumer sentiment, private consumption continued to increase moderately due to the effects of measures to stimulate demand for automobiles. It was expected to remain firm as the employment situation was on an improving trend.

Housing investment had generally been picking up, supported in part by reconstruction of disaster-stricken homes, and was expected to continue to do so.

The recent reading on production had been relatively weak. Production was expected to increase moderately as domestic demand remained firm and as exports picked up gradually. On the basis of interviews with firms, not a few maintained a conservative outlook on their production plans, and production was expected to increase only marginally in the July-September quarter through the October-December quarter of 2012.

As for prices, international commodity prices had picked up slightly, after having fallen back through June 2012. The three-month rate of change in the domestic corporate goods price index (CGPI) had turned negative, mainly reflecting the earlier decline in international commodity prices. The CGPI was for the time being expected to continue declining moderately, mainly due to persisting effects of the decline in international commodity prices. The year-on-year rate of change in the corporate services price index (CSPI) for all items excluding international transportation, having seen a deceleration in the pace of decline, had recently been around 0 percent. 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 were accommodative.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. 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. That of CP had also been positive. In contrast, the year-on-year rate of change in the amount outstanding of corporate bonds had been negative as the amount of electric company bonds redeemed continued to exceed the amount issued. 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 percent.

The first disbursement of the fund provision under "Special Rules for the U.S. Dollar Lending Arrangement to Enhance the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth" was to take place on September 6, 2012, with loan rates at 6-month U.S. dollar LIBOR (London InterBank Offered Rate published by the British Bankers' Association). However, following recent developments regarding the reform of LIBOR among interested parties, the Bank decided to delay the first disbursement of the U.S. dollar fund provision. It aimed to carry out the first disbursement of the U.S. dollar fund provision at an early date, taking into account the expected progress of LIBOR reform in early autumn.

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 continued to be seen, mainly due to concern about the European debt problem, and therefore particular attention should be paid to developments in these markets for the time being. Some members said that the markets had recently been in a lull due to expectations for policy actions by the European authorities. However, these members continued that there was basically no change in the situation where market sentiment tended to fluctuate between optimism and pessimism following events such as remarks by officials, as there remained a high degree of uncertainty about the European debt problem, including how fiscal and economic structural reforms would develop. Meanwhile, members noted that the situation of interbank funding markets was of importance in terms of ensuring the stability of the financial system, and shared the recognition that the markets remained generally stable, due to the effects of the provision of a large amount of funds by the ECB. They continued that it was therefore less likely that serious disturbances in global financial markets would trigger a severe global economic downturn -- a scenario that was a matter of significant concern at around the end of 2011. Some members noted that, although liquidity provision by the central bank could provide a temporary reprieve -- that is, serve as a measure to buy time -- this alone would not lead to the resolution of the European debt problem. These members continued that financial market conditions might deteriorate again without the prompt implementation of structural reforms such as drastic fiscal reforms, labor market reforms, and reforms aimed at stabilizing and strengthening the financial system. One member added that attention should be paid to the fact that market tensions were likely to heighten at the end of each quarter as financial institutions' funding conditions tended to become tight. With regard to the fact that long-term interest rates in the United States and Germany had been at historically low levels, a few members noted that this seemed to reflect an increasing demand for safe assets in a situation where concern over the European debt problem had not yet been relieved. These members continued that developments in these rates should nevertheless be monitored closely because they could affect long-term interest rates in Japan.

Members concurred that overseas economies had shown moderate improvement, though limited in scope; on the whole, they still had not emerged from a deceleration phase. Some members expressed the recognition that this deceleration phase had been somewhat more prolonged than expected, partly because the business sentiment had been deteriorating globally on the back of the European debt problem. Members shared the view that, although the outlook remained highly uncertain, overseas economies were likely to gradually emerge from the deceleration phase. One member commented that it would probably take time before the state of the economy in the euro area emerged from a state of sluggishness, and therefore the expected recovery in overseas economies depended largely on developments in the U.S. and Chinese economies.

As for the U.S. economy, members agreed that it generally continued to recover at a moderate pace and was likely to continue to do so, supported mainly by the accommodative financial conditions. Many members expressed the recognition that signs of weakness were observed, such as in business sentiment; behind this, households and firms found it difficult to be active in their spending amid persisting strains from balance-sheet adjustments. These members continued, however, that private consumption remained firm reflecting (1) improvement in real purchasing power as a result of a decline in gasoline prices and (2) relatively firm stock prices; moreover, home sales showed some signs of a pick-up. A few members said that, although housing investment had been showing signs of an increase, its effects in terms of boosting overall economic activity, including the ripple effects on private consumption, should be viewed conservatively as the ratio of housing investment to GDP had declined.

In the euro area, members agreed that economic activity had been sluggish due to stagnant domestic demand. They also agreed that the economy was likely to remain sluggish for the time being given that fiscal austerity and severe financial conditions were likely to continue, particularly in peripheral countries. Some members expressed the view that the weakening of household and business sentiment had been spreading from peripheral countries to core countries recently. Some members noted that the increasingly sluggish euro area economy was exerting downward pressure on the global economy through a contraction in global trade. One member raised the possibility that the malfunctioning of European financial institutions' financial intermediation was discouraging international financial transactions, thereby hindering the economic activity of firms and consequently global economic growth. On this point, a different member commented that the effects of deleveraging by European financial institutions in Central and Eastern European economies had so far been less serious than previously anticipated.

Members shared the view that, although the Chinese economy continued to show relatively high growth, the pace of economic growth was slowing and this situation had been somewhat more prolonged than expected. Some members said that such a slowdown partly reflected the lagged effects of monetary tightening and measures to restrain real estate speculation, which had been implemented so that the economy could make a soft landing by simultaneously achieving price stability and economic growth. As for the outlook, most members expressed the view that the Chinese economy was likely to gradually show clear signs of recovery, as suggested by an uptick in real estate sales, although the timing of such recovery was slightly delayed. These members said that, in addition to successive monetary easing measures implemented in response to the recent decline in inflation rates, future infrastructure investment plans were being brought forward and measures to stimulate consumption had been taken, and that, together with improvement in households' real purchasing power, these measures were likely to gradually produce policy effects. As for infrastructure investment, one member added that per capita capital stock was still low, and there was room to expand productive investment. With regard to the outlook for the Chinese economy, some members commented on the following possibilities: (1) the cautious policy stance of the Chinese authorities would prolong the economy's deceleration phase; and (2) asset prices would rise even in a sluggish economic situation due to stimulus measures generating a spending spree in the real estate market. Regarding the NIEs and the ASEAN countries, members concurred that the pace of economic growth had begun to pick up on the whole, as private consumption and business fixed investment had been firm, due mainly to policy measures such as monetary easing. They continued, however, that the momentum of growth in exports had slowed and business sentiment had become cautious.

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 Japan's economic activity had started picking up moderately as domestic demand remained firm, mainly supported by reconstruction-related demand. They shared the recognition that, although overseas economies still had not emerged from a deceleration phase and overseas demand had been somewhat sluggish, domestic demand remained firm and developments in the economy as a whole were broadly in line with the forecast in the July 2012 interim assessment. Members concurred that public investment continued to increase 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 improvement in corporate profits. One member said that it had been confirmed again that, in a survey by the Development Bank of Japan, business fixed investment plans showed a clear increase from the previous fiscal year. This member continued that it was nevertheless necessary to continue to carefully monitor whether such investment would indeed be carried out as planned, because the actual figures for the April-June quarter and the forecast figures for the July-September quarter for machinery orders were relatively weak. Members shared the recognition that, against the background of improvement in consumer sentiment, private consumption had continued to increase moderately due to the effects of measures to stimulate demand for automobiles, and that housing investment had generally been picking up. They concurred that the pick-up in exports had moderated, due mainly to a decline in those to Europe, and that the industrial production data, which were greatly affected by developments in exports, had recently been somewhat weak. A few members pointed out that the deceleration in the pace of Chinese economic growth had been adversely affecting shipment of intermediate goods and capital goods from Japan to China. A few other members said that, even if the Chinese economy emerged from the deceleration phase as a result of an increase in real estate investment, this might not exert a significant impact on Japan's exports. Some members noted that the actual industrial production index figures tended to be lower than the forecast figures recently, and said that it was necessary to carefully examine future developments in industrial production. On the point that production of late lacked momentum, some members expressed the view that -- although this basically reflected recent developments in exports -- firms might have begun to make production adjustments in anticipation of a possible deceleration in exports and waning of policy effects. A few members added that, if the Bank were to release its view on activity in the manufacturing sector -- namely, that the recent reading on production had been relatively weak -- it was necessary to provide a thorough explanation to prevent this from being misinterpreted as weakness in the GDP, which represented the activity in all industries including the nonmanufacturing sector.

As for the outlook for the economy, members agreed that it was likely to return to a moderate recovery path as domestic demand remained firm and overseas economies emerged from the deceleration phase. They then shared the recognition that the key factor was whether domestic demand would remain firm until a recovery in overseas demand became evident. On this point, many members expressed the view that it was necessary to closely monitor the effects of the dissipation of some of the factors that underpinned the current firmness in private consumption; for example, the running out of funds in the budget allocated for subsidies for purchasers of environmentally friendly cars and the waning of pent-up demand following the earthquake disaster. These members continued, however, that if corporate profits kept improving with an increase in demand at home and abroad, as well as a rise in production, this was likely to lead to an increase in business fixed investment and to an improvement in the employment and income situation, thereby underpinning private consumption. One member commented that baby boomers' consumption of services could also underpin private consumption. A different member added that, because the reconstruction following the earthquake disaster had been progressing gradually, its effects would be realized over time and it could therefore continue to act as an underpinning factor for the economy over the long term.

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, 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, while it had already exerted a considerable adverse impact on the global economy, a further worsening of the problem leading to disturbances in global financial markets -- and consequently to a further deceleration in the global economy -- was still the risk of most concern. One member added that it was important not to underestimate the adverse impact of the European debt problem, as it could spread at an unexpected pace. With regard to uncertainty over the outlook for the U.S. economy, some members noted that, in addition to the adverse impact of the European debt problem, it was necessary to carefully monitor the effects of the "fiscal cliff" -- a state in which fiscal spending cuts would be implemented and tax cuts would expire at the beginning of 2013 --

as they had already begun to materialize in the form of deterioration in business sentiment amid persisting strains from balance-sheet adjustments. Regarding risks to the outlook for emerging and commodity-exporting economies, a few members expressed the view that there remained a high degree of uncertainty about whether recovery in these economies could be realized while simultaneously achieving price stability, considering that grain prices had recently been rising significantly. Regarding the outlook for overseas economies as a whole, some members commented that, even if these economies might not experience a significant downturn, the risk that their deceleration phase would be prolonged was not small, and the timing for a return of Japan's economy to a moderate recovery path might be delayed if such a risk materialized.

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. Most members expressed the view that the recent developments in the CPI were largely affected by the fact that the year-on-year rate of change in the prices of petroleum products had turned negative due to a decline in crude oil prices, and that, taken together with developments in the economy, the developments in the CPI were broadly in line with the forecast in the July 2012 interim assessment. As background to the recent developments in the CPI, a few members pointed to the following factors, in addition to the effects of the decline in crude oil prices: (1) it was possible that the effects of the slower pace of improvement in the negative output gap since the end of 2011 were being reflected with a time lag, and (2) the recovery in firms' pricing power seemed to be stalling.

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. Some members, noting that households' and firms' short-term inflation expectations were susceptible to actual price developments, expressed the view that attention should be paid to the possibility of heightened expectations that prices were unlikely to rise, given that the year-on-year rate of change in the CPI had remained at a low level for a long time, and this in turn could lead to a slower pace of increase in prices than that suggested by the improvement in the negative output gap. One member expressed the view that, considering the experience gained from the situation seen through 2008, when the output gap turned positive, it might also take a while before the rate of change in the CPI for all items less energy and food turned clearly positive, under the current circumstances. A few members said that, given the situation of summer bonus payments and developments in regular payments, a cautious view regarding the outlook for prices was inevitable. In response, a different member said that the continued improving trend in the employment conditions for part-time workers and efforts to boost demand from the elderly for services might lead to a rise in prices to some extent. A few members noted that, for households' and firms' inflation expectations to rise in a situation where demographic changes were exerting forces to shrink the market, a rise in growth expectations was deemed necessary.

B. Financial Developments

Members shared the view that financial conditions in Japan were accommodative. Some members commented that, after examining various indicators in a comprehensive manner, it was appropriate to take a step forward in the Bank's assessment of financial conditions, and change the phrase from "financial conditions in Japan continue to ease" -- an assessment of changes in the conditions -- to "financial conditions in Japan are accommodative" -- an assessment of the overall levels.

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 remained on an improving trend.

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

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that it 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 <u>monetary policy for the immediate future</u>, 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 by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side, the Bank had been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. They agreed that the Bank would continue to conduct monetary policy in an appropriate manner. A few members reaffirmed their view that, in a situation where the extremely accommodative financial conditions were not fully taken advantage of -- as evidenced, for example, by firms' fixed investment being kept within the level of cash flow -- merely providing support from the financial side would not be enough and continued efforts to strengthen the economy's growth potential were necessary. One member expressed the recognition that, while nearly two years had passed since the Bank started to implement the comprehensive monetary easing measures, Japan's economy had not yet overcome deflation, and thus it might be necessary for the Bank to devise further ways to boost inflation expectations, such as exerting influence on foreign exchange rates. A different member said that the effects of monetary policy could be constrained if market participants began to question the Bank's stance toward overcoming deflation. In response, another member -- noting that strengthening the economy's growth potential was essential in order for the effects of the accommodative financial conditions to permeate economic activity -- said that the Bank should clearly communicate to the public its firm intention to ensure the return of Japan's economy to a sustainable growth path with price stability.

Members reaffirmed their view that it was necessary for the Bank to do its utmost to ensure that the current stability of Japan's financial system would be firmly maintained while paying particular attention to developments in global financial markets, where some nervousness persisted, reflecting the European debt problem. Some members said that Japan's economy could be adversely affected through various channels if, for example, a substantial risk materialized, stemming from the European debt problem. These members continued that the Bank should therefore stand ready to take appropriate actions without ruling out any options in advance. A few members added that it was also important for the Bank to fully communicate to the public that it was prepared to take appropriate policy actions in a decisive manner to secure credibility pertaining to the timeliness of monetary policy conduct.

In terms of the Program, members agreed that it was appropriate to proceed with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program, which was expanded as a result of the decision made at the April 27 meeting, and also to monitor its effects. Some members said that the effects of monetary easing had been permeating the financial markets steadily as the Bank proceeded with asset purchases within the current total size of the Program. With regard to the measures to steadily increase the amount outstanding of the Program decided at the previous meeting on July 11 and 12, members shared the view that the level of bidding activity had been favorable for the Bank's outright purchases of T-Bills -- the amount of which was increased by the allocation of funds from the fixed-rate operation -- and therefore the intended purpose had been achieved. Some members, noting that yields on T-Bills remained slightly below the 0.1 percent level even after the Bank removed the minimum bidding yield for T-Bills' outright purchases, pointed out that arbitrage was working sufficiently between the market rates and the interest rate applied to the complementary deposit facility. One member expressed the view that market participants clearly understood the Bank's policy stance to increase the amount outstanding of the Program to about 65 trillion yen by around end-2012 and about 70 trillion yen by around end-June 2013 through the measures decided at the previous meeting. A different member added that the Bank should explain to the public more thoroughly that such measures were decided in order to pursue powerful monetary easing forcefully. Meanwhile, as for the undersubscription that occurred in the Bank's outright purchases of JGBs, members concurred that it was appropriate for the Bank to examine financial institutions' bidding behavior in the upcoming JGB purchases, since a single occurrence of undersubscription did not mean that it would immediately become difficult to increase the amount outstanding of the Program. With regard to the background to the undersubscription in the Bank's JGB purchases, members shared the view that this was partly due to the fact that yields on government bonds had declined to an extremely low level in Japan as well. On this basis, many members expressed the view that counterparty financial institutions' stance toward bidding for the outright purchases of JGBs might be affected not only by developments in interest rates overseas, but also by each financial institution's portfolio management and by market speculation that the minimum bidding yield for outright purchases of JGBs might be removed. One member added that it was important for the Bank to communicate to the public in an effective manner so as to avoid an unnecessary heightening of such speculation.

IV. Remarks by Government Representatives

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

(1) The government was currently making its best efforts to work on the comprehensive reform of the social security and taxation systems. It expected to promptly obtain the Diet's approval of bills related to the comprehensive reform, which were being deliberated in the House of Councillors.

(2) The Japanese economy was on the way to recovery at a moderate pace. As for the outlook, movement toward sound recovery was expected to take hold. However, there were widespread concerns about a further slowing down of overseas economies against the background of continued high concern over the European debt problem. There was a risk that these circumstances -- including negative effects that could stem from sharp fluctuations in the financial markets, such as a further appreciation of the yen -- could exert downward pressure on the Japanese economy. The government considered that the risk of a global economic downturn, mainly stemming from the European debt problem, warranted even closer attention. It expected the Bank to continue to carefully monitor how developments in overseas economies would affect the Japanese economy and to make every effort to avoid a slowdown. Furthermore, the government expected the Bank to fully communicate such efforts to the public at home and abroad.

(3) The government and the Bank shared the view that overcoming deflation was an important task in Japan, and had been making policy efforts while sufficiently exchanging views and keeping close contact. The "Comprehensive Strategy for the Rebirth of Japan," which had recently been decided by the Cabinet, aimed to realize a virtuous economic cycle and the growth accompanying an increase in income, as well as to overcome deflation and revitalize the economy. Furthermore, as part of this strategy the Bank was expected to continue powerful monetary easing until the exit from deflation was ensured.

(4) The Bank had been conducting monetary policy based on its 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; however, given that the CPI inflation rate was still below 1 percent, Japan had not yet overcome deflation. The government expected the Bank to continue to conduct monetary policy vigorously and decisively for

the purpose of achieving the goal of 1 percent, while monitoring developments in financial markets at home and abroad and working sufficiently on its communication 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 Japanese economy was on the way to recovery at a moderate pace, partly supported by reconstruction demand. As for the outlook, movement toward sound recovery was expected to take hold. However, in addition to the risk of electric power supply constraints, there were widespread concerns about a further slowing down of overseas economies while a high degree of uncertainty about the prospects of the European debt problem remained. The fact that these circumstances were posing downside risks to the Japanese economy required strong vigilance.

(2) Recent price developments indicated that the Japanese economy remained in a mild deflationary situation. Nevertheless, the government considered that the current circumstances provided a good opportunity for the economy to overcome deflation decisively, since the negative output gap was narrowing reflecting the rise in domestic demand. In order to overcome deflation decisively, a challenge Japan had confronted for a long period, it was extremely important to deal with the structural factors in the Japanese economy that tended to generate deflation, while also implementing monetary policy measures.

(3) Based on the "Comprehensive Strategy for the Rebirth of Japan," which had recently been decided by the Cabinet, the government would steadily advance its efforts to strengthen Japan's growth potential. In particular, with a view to enhancing the flow of goods, people, and capital, the government -- while remaining aware of the economic situation through fiscal 2013 -- would work toward overcoming deflation by employing policy measures such as regulatory and system reforms, the budget and the Fiscal Investment and Loan Program, and tax incentives. It would closely monitor the economic situation and risks to the economy and make flexible and swift responses, as necessary.

(4) The government expected the Bank to continue to make its utmost efforts in the conduct of monetary policy in parallel with these government measures. The government deemed it particularly important for the Bank to produce visible results by achieving as

promptly as possible a CPI inflation rate of 1 percent, the rate the Bank aimed to achieve for the time being. It expected the Bank to steadily implement the purchases of financial assets and continue powerful monetary easing until the exit from deflation was ensured.

(5) This was the first Monetary Policy Meeting for two new Policy Board members, who had long served as economists. The government expected them to participate in discussions in an open-minded manner, laying a wide range of options on the table for consideration, and to further facilitate smooth communication with markets.

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, Mr. K. Ishida, Mr. T. Sato, and Mr. T. Kiuchi.

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 July 11 and 12, 2012 for release on August 14, 2012.

Attachment

August 9, 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 have shown moderate improvement, though limited in scope; on the whole, they still have not emerged from a deceleration phase. In global financial markets, some nervousness continues to be seen, mainly due to concern about the European debt problem. Particular attention should therefore be given to developments in these markets for the time being.

3. Japan's economic activity has started picking up moderately as domestic demand remains firm mainly supported by reconstruction-related demand. Public investment has continued to increase. Business fixed investment has been on a moderate increasing trend with improvement in corporate profits. Against the background of improvement in consumer sentiment, private consumption has continued to increase moderately due to the effects of measures to stimulate demand for automobiles. Housing investment has generally been picking up. The pick-up in exports has moderated, and the recent reading on production has been relatively weak. Meanwhile, financial conditions in Japan are accommodative. 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 domestic demand remains firm and overseas economies emerge from the deceleration phase. 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 by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side. Based on this recognition, the Bank has been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. It will proceed with the monetary easing in a continuous manner by steadily increasing the amount outstanding of the Asset Purchase Program. The Bank continues to conduct monetary policy in an appropriate manner. The Bank will also do its utmost to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets.