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June 14, 2013

Bank of Japan

Minutes of the Monetary Policy Meeting

on May 21 and 22, 2013

(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 21, 2013, from 2:00 p.m. to 4:26 p.m., and on Wednesday, May 22, from 9:00 a.m. to 12:02 p.m.[1]

Policy Board Members Present

Mr. H. Kuroda, Chairman, Governor of the Bank of Japan

Mr. K. Iwata, Deputy Governor of the Bank of Japan

Mr. H. Nakaso, 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. S. Yamaguchi, 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. Matsuyama, Vice Minister for Policy Coordination, Cabinet Office

Reporting Staff

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director (Assistant Governor)

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

Mr. K. Kamiyama, Head of Policy Planning Division, 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 10 and 11, 2013 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 Mr. S. Yamaguchi was present on May 22.

3 Mr. S. Sato was present on May 21.

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

Mr. E. Maeda, Director-General, Research and Statistics Department

Mr. S. Kameda, Head of Economic Research Division, Research and Statistics Department

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

Secretariat of the Monetary Policy Meeting

Mr. N. Yoshioka, Director-General, Secretariat of the Policy Board

Mr. N. Fukunaga, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. Y. Komaki, Senior Economist, Monetary Affairs Department

Mr. T. Kawamoto, 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 April 26, 2013, had been providing funds through purchases of Japanese government bonds (JGBs) and other measures.[5] In this situation, the amount outstanding of the monetary base had been in the range of 148-157 trillion yen.

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been at low levels. The uncollateralized overnight call rate had been at a level below 0.1 percent. General collateral (GC) repo rates had been more or less flat at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) including those with longer maturities had been at around 0.1 percent. Rates on longer-term interbank instruments had been flat.

With regard to long-term interest rates, yields on 10-year JGBs had temporarily declined to around 0.55 percent, due in part to the solid bidding in a JGB auction amid declining U.S. and European long-term interest rates toward the beginning of May 2013. Thereafter, however, these yields rose to the range of 0.8-0.9 percent -- accompanied by heightening volatility -- against the background of the rise in U.S. and European long-term interest rates following the stronger-than-expected U.S. economic indicators, as well as the further depreciation of the yen and the rise in Japanese stock prices. Developments in yields on 5- and 20-year JGBs had generally followed those on 10-year JGBs, and yields on 2-year JGBs had risen, albeit slightly. The Nikkei 225 Stock Average had been on a rising trend, reflecting the rise in U.S. and European stock prices and expectations of improvements in corporate profits, mainly due to the further depreciation of the yen. Prices for Japan real estate investment trusts (J-REITs) had been declining, partly due to the emergence of market concerns about deterioration in the supply and demand balance following the announcement of a large initial public offering in a situation where the prices had signaled a halt to the rising trend that had continued since autumn 2012. Yield spreads

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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 conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

between corporate bonds and JGBs were more or less unchanged at low levels on the whole, reflecting solid demand from investors, although those on some corporate bonds remained wide due to deterioration in issuer companies' business performance. In the foreign exchange market, the yen had been depreciating against the U.S. dollar, mainly in response to expectations for the expansion of investment in foreign currency-denominated bonds by Japanese investors, in addition to speculation about the direction of U.S. monetary policy, which was triggered by the stronger-than-expected U.S. economic indicators. The U.S. dollar/yen rate had recently been in the range of 102-103 yen.

C. Overseas Economic and Financial Developments

Overseas economies had been moving out of the deceleration phase that had continued since last year and were gradually heading toward a pick-up.

The U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, despite downward pressure from the fiscal side. Federal government expenditures -- particularly federal defense spending -- had been declining. Although effects of the expiration of the payroll tax cut had been observed, private consumption continued to be on a moderate increasing trend as the employment situation followed an improving trend and asset prices rose. Housing investment had also been picking up steadily, partly supported by the low interest rate. Exports were emerging from a leveling-off phase. On the back of these developments in demand at home and abroad, production had returned to an increasing trend and business fixed investment had begun to pick up. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items had decelerated somewhat, mainly as a result of the decline in energy prices. However, the year-on-year rate of increase in the CPI for all items less food and energy, or the core CPI, had been more or less flat.

Economic activity in Europe continued to recede slowly. Exports had begun to bottom out and further deterioration in business and household sentiment was coming to a halt on the whole, albeit with some differences in degree by country. Nevertheless, both business fixed investment and private consumption had been declining, partly due to continuing fiscal austerity amid the protraction of the European debt problem. Production continued to decrease, reflecting sluggish domestic demand. As for prices, while slack in supply and demand conditions was exerting downward pressure on prices, the year-on-year rates of increase in both the Harmonized Index of Consumer Prices (HICP) for all items and the HICP excluding energy and unprocessed food had declined. Meanwhile, economic activity in the United Kingdom had been sluggish.

With regard to Asia, the Chinese economy had been stabilizing in reflection of firm domestic demand. Private consumption had been firm on the back of a favorable employment and income situation. The pace of increase in fixed asset investment had been solid, mainly due to rises in infrastructure investment and real estate investment. Exports were heading toward a pick-up, albeit with some fluctuations. Reflecting these developments in demand at home and abroad, production had been stabilizing as well. Regarding the NIEs and the ASEAN countries, these economies had been picking up on the whole, but the pace still continued to be moderate in the corporate sector. Exports were heading toward a pick-up, albeit with some fluctuations, and production had shown signs of stabilizing. Nevertheless, growth in business fixed investment, particularly in the NIEs, had been sluggish as business sentiment still remained cautious. Meanwhile, private consumption had been firm, especially in the ASEAN countries, where consumer sentiment was on an improving trend on the back of the favorable employment and income situation. As for prices, inflation rates had generally been more or less flat, although there were regional differences. In India, the economy remained in a state of deceleration.

In global financial markets, investors' risk-taking stance had strengthened somewhat, on the back of the stronger-than-expected U.S. economic indicators, the additional step of monetary easing by the European Central Bank (ECB), and the abatement of uncertainty over the European situation, mainly due to the formation of a new government in Italy. Under these circumstances, stock prices had risen in the United States and Europe, as well as in emerging economies. In the bond market, while yields had risen on government bonds in the United States, Germany, and France, those in some peripheral European countries had declined, and yield differentials between sovereign bonds in emerging economies and U.S. Treasuries had narrowed. With regard to global capital flows, the net capital inflow into emerging economies, which had recently been decreasing, had started to increase. Capital inflow into U.S. and European high-yield bonds had recovered, and consequently their yields temporarily declined to historically low levels. Meanwhile, international commodity prices had recently moved slightly upward on the whole, although they continued to be weak from a relatively longer-term perspective in a situation where recovery in emerging economies lacked momentum.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had stopped decreasing. Real exports had increased in the January-March quarter of 2013 for the first time in three quarters, after having continued to decline considerably for two consecutive quarters through the October-December quarter of 2012 on a quarter-on-quarter basis. Exports were expected to pick up, mainly against the background that growth rates of overseas economies would gradually pick up.

Public investment continued to increase. The amount of public construction completed -- a measure that reflected the progress of public works -- had increased slightly in the January-March quarter on a quarter-on-quarter basis, after having risen for four quarters in a row through the October-December quarter. The value of public works contracted -- a measure that reflected public works orders -- had dipped marginally in the January-March quarter, after having continued to be more or less flat on average, albeit with monthly fluctuations, since the April-June quarter of 2012, but it increased markedly at the start of the new fiscal year in April 2013. Public investment was expected to continue trending upward, supported by the effects of various economic measures.

Business fixed investment continued to show resilience in nonmanufacturing and appeared to have stopped weakening on the whole -- including that in manufacturing, which had been declining due to weakness in overseas economies. The aggregate supply of capital goods -- a coincident indicator of machinery investment -- had increased in the January-March quarter on a quarter-on-quarter basis, after having decreased for two quarters in a row through the October-December quarter. Machinery orders (private sector, excluding orders for ships and those from electric power companies) -- a leading indicator of machinery investment -- had been almost flat in the January-March quarter, after having declined for three straight quarters through the October-December quarter. Construction starts (floor area, private, nondwelling use) -- a leading indicator of construction investment -- had continued to move upward for five consecutive quarters through the January-March quarter. Business fixed investment was projected to follow a moderate increasing trend, partly due to investment related to disaster prevention and energy, as corporate profits headed toward improvement.

The employment and income situation remained severe, but supply and demand conditions in the labor market had been improving again.

Private consumption had seen increased resilience, assisted by the improvement in consumer sentiment. On a GDP basis (first preliminary figures), real private consumption had registered high growth of 0.9 percent in the January-March quarter on a quarter-on-quarter basis, after having increased by 0.4 percent in the October-December quarter. Sales at retail stores in real terms had risen in the January-March quarter on a quarter-on-quarter basis, after having been more or less level through the October-December quarter, albeit with some fluctuations. Sales at department stores had climbed markedly in the January-March quarter, assisted mainly by increased sales of high-end goods, after having risen in the October-December quarter -- notably in winter apparel -- affected by lower temperatures. Private consumption was expected to remain resilient.

Housing investment had generally been picking up and was expected to continue to do so.

Reflecting these developments in demand both at home and abroad, industrial production had stopped decreasing and signs of picking up had become increasingly evident. On a quarterly basis, it had increased in the January-March quarter in terms of the released-base index, while it had been almost flat in terms of the adjusted-base index, after having declined for three quarters in a row since the April-June quarter of 2012.[6] As for the shipment-inventory balance, inventories had continued to decline as shipments turned upward in the January-March quarter on a quarter-on-quarter basis. As a result, the balance had improved, providing grounds for production to increase. Industrial production was projected to pick up, mainly reflecting developments in demand at home and abroad. Judging from interviews with firms, production was projected to increase markedly in the April-June quarter of 2013.

[6] The adjusted-base index of industrial production was seasonally adjusted figures calculated by detecting large fluctuations after the Lehman shock as outliers (estimation by the Research and Statistics Department, Bank of Japan).

As for prices, the domestic corporate goods price index (CGPI) was rising relative to the level three months ago, reflecting movements in foreign exchange rates. The domestic CGPI was expected to continue rising for the meantime. The year-on-year rate of change in the CPI (all items less fresh food) had been negative, due to the reversal of the previous year's movements in energy-related and durable consumer goods. It was expected to register smaller declines for the time being, and thereafter was likely to gradually turn positive. Meanwhile, some indicators suggested a rise in inflation expectations.

2. Financial environment

Financial conditions were accommodative.

The monetary base had increased significantly as asset purchases by the Bank had progressed, and the year-on-year rate of growth had been in the range of 20-25 percent.

Firms' funding costs had been hovering at low levels. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP and corporate bonds remained favorable on the whole, although new issuance of bonds by some firms had been temporarily deferred recently, in response to the rise in long-term interest rates. Firms' credit demand had been increasing moderately, mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of increase in the amount outstanding of bank lending, mainly that of major banks, had risen somewhat. The year-on-year rate of change in the amount outstanding of CP and corporate bonds had been positive. Firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of growth in the money stock had been in the range of 3.0-3.5 percent, mainly due to the increase in bank lending.

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

A. Economic Developments

In terms of global financial markets, members shared the recognition that investors' risk-taking stance had strengthened somewhat, reflecting the abatement of uncertainty over the European situation and monetary easing in both advanced and emerging economies, and that a capital inflow into risk assets had been observed on a global basis. One member noted that U.S. long-term interest rates had recently risen somewhat, reflecting emerging speculation that the Federal Reserve would reduce the pace of its asset purchases earlier than expected. This member continued that, if such unwinding of monetary easing in the key currency country were to proceed, the member would carefully monitor how this development would affect global financial markets and consequently the world economy, including Japan's economy.

Members concurred that <u>overseas economies</u> had been moving out of the deceleration phase that had continued since last year and were gradually heading toward a pick-up as a whole, although some signs of weakness were observed in the euro area and Asian economies. They continued that the growth rates of overseas economies -- in particular, the United States -- would gradually pick up. On this basis, some members expressed the view that the global disinflationary trend was continuing, mainly reflecting weak international commodity prices and persistent excess supply on a global scale, and therefore it was necessary to closely monitor whether or not such developments would exert an adverse impact on overseas economies through a decline in medium- to long-term inflation expectations and a rise in real interest rates.

Members shared the recognition that the U.S. economy had been on a moderate recovery trend against the backdrop of steady private demand, such as private consumption and housing investment, despite downward pressure from the fiscal side. One member commented that, for roughly the past three years, U.S. economic indicators had followed the same pattern -- namely, that they had been firm from the beginning of the year through early spring and then had become somewhat weak toward summer. However, this member continued that recent economic indicators such as U.S. employment statistics for April 2013 suggested that the U.S. economy seemed to have avoided this pattern this year. As for the outlook, members concurred that, although downward pressure from the fiscal side would remain, the economy was likely to continue recovering at a moderate pace, mainly reflecting accommodative financial conditions and the positive impact of new energy sources. A few members expressed the view that the possibility of the materialization of a downside risk -- namely, the fiscal problem in the United States -- had slightly decreased, given that the deficit for fiscal 2013 was projected to shrink considerably. One of these members was paying attention to the point that, although the decline in the U.S. fiscal deficit could be regarded as an indication of the strong downward pressure from the fiscal side, the U.S. economy continued to be relatively resilient as a trend.

Members shared the recognition that economic activity in the euro area continued to recede slowly. As background to the prolongation of the economic recession, one member pointed to the adverse feedback loop operating between household and banking sectors -- namely, in which banks maintained their cautious lending stance toward small firms and households due to the worsening of the employment situation and the real estate market, and this stance consequently led to even further deterioration in the employment situation and the real estate market. A different member noted that the economic recovery was considerably hindered by the fact that peripheral countries were unable to conduct their own monetary policy. On this point, another member commented that, because adjustments in exchange rates could not be made within the euro area, it might not be avoidable that countries with low competitiveness would face disinflationary pressure in terms of correcting the disparity in competitiveness. Based on this discussion, members concurred that the euro area economy was likely to continue receding slowly for the time being. On this basis, a few members said that changes in the stance of fiscal austerity observed recently might involve a risk of inducing a negative response from the market, but that these could be expected to underpin the economy for the time being.

Members concurred that the Chinese economy had been stabilizing in reflection of firm domestic demand. As for the outlook, they shared the view that, amid continued firm domestic demand -- such as infrastructure investment -- the growth rate would pick up, albeit moderately. On this basis, many members expressed the recognition that momentum toward recovery for the Chinese economy was somewhat weaker than had been expected. As background to this, these members pointed to the following: (1) excess capital stock and a prolonged inventory adjustment in the manufacturing sector; and (2) the government's policy stance that placed more emphasis on structural adjustments than on high economic growth.

Regarding the NIEs and the ASEAN countries, members concurred that these economies had been picking up on the whole, but that the pace of the pick-up remained moderate in the corporate sector, as evidenced by South Korea's and Taiwan's somewhat weak exports. As for the outlook, they shared the view that, in a situation where solid private consumption underpinned these economies -- especially the ASEAN economies -- the pace of recovery was likely to increase in turn as exports picked up gradually.

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

Members concurred that the economy had started picking up, as evidenced by the recent increase in positive developments, such as in private consumption, business fixed investment, and industrial production. They shared the recognition that private consumption had seen increased resilience, assisted by the improvement in consumer sentiment, amid the rising trend in stock prices. On this basis, a few members expressed the following view regarding why household spending, such as private consumption and housing investment, had been firmer relative to the employment and income situation. Specifically, they noted that, in addition to wealth effects and the improvement in consumer sentiment, the bringing forward of future demand underpinned household spending, as shown by (1) purchases of high-end goods in anticipation of a rise in prices brought about by the depreciation of the yen and (2) purchases of housing in view of the scheduled consumption tax hikes. These members continued that attention therefore should be paid to the sustainability of such household spending. One member noted that improvement in regular payments, which would lead to a rise in permanent income, was necessary to attain a sustainable increase in private consumption, but such improvement had not yet been confirmed. Members concurred that business fixed investment continued to show resilience in nonmanufacturing and appeared to have stopped weakening on the whole, including that in manufacturing, which had been declining due to weakness in overseas economies. They concurred that industrial production had stopped decreasing due to a halt in the decline in exports and to resilient domestic demand, and signs of picking up in industrial production had become increasingly evident.

As for the outlook for the economy, members shared the view that the economy was likely to return to a moderate recovery path around mid-2013, mainly against the background that domestic demand remained resilient due to the effects of monetary easing as well as various economic measures, and that growth rates of overseas economies gradually picked up. Most members expressed the view that developments in business fixed investment were the key to whether the momentum for economic recovery would increase. In relation to this, many members pointed to the following as positive developments: (1) if a pick-up in exports and industrial production became evident as the growth rates of overseas economies rose, the effects could spread to business fixed investment; (2) corporate profits for fiscal 2013 were projected to increase considerably, due in part to the positive contribution from the yen's depreciation in the foreign exchange market; and (3) survey results indicated a clear improvement in firms' appetite for business fixed investment since around end-2012. In response, a few members took a somewhat cautious view on the outlook for manufacturing, noting that (1) sentiment in manufacturing remained somewhat cautious despite the further depreciation of the yen and (2) the capacity utilization rate in manufacturing remained at a low level.

With regard to risks to the outlook for Japan's economy, members concurred that there remained a high degree of uncertainty concerning the economy, including the prospects for the European debt problem and the growth momentum of the U.S. economy as well as the emerging and commodity-exporting economies. One member said that attention should be paid to whether a delay in the recovery of business fixed investment worldwide would defer the timing of recovery in Japan's exports. As an upside risk factor, a different member pointed to the possibility that the government's recent efforts in formulating its growth strategy would raise firms' and households' growth expectations relatively quickly.

Regarding prices, members agreed that the year-on-year rate of change in the CPI (all items less fresh food) had been negative, due to the reversal of the previous year's movements in energy-related and durable consumer goods. They shared the view that some indicators -- particularly in the results of surveys conducted on households and market participants, as well as market indicators -- suggested a rise in inflation expectations, although the scheduled consumption tax hikes appeared to be playing a role in this rise, and this warranted attention. In terms of the outlook for prices, members shared the view that the year-on-year rate of change in the CPI (all items less fresh food) was likely to register smaller declines for the time being as the effects of the previous year's movements dissipated, and thereafter was likely to gradually turn positive, partly due to an improvement in the aggregate supply and demand balance. On this basis, one member said that it was necessary to ascertain whether the rate of change in the CPI would turn positive as a trend, not only the CPI for all items less fresh food but also the CPI for all items less food and energy, and the trimmed mean CPI. With regard to the rise in prices of imported materials due to the recent depreciation of the yen, some members noted that close attention should be paid to whether this rise would be passed on to retail sales prices even as retail firms remained under a highly competitive environment, and further, whether there was any possibility that profits of small firms would be squeezed in this process. On this point, one member was of the view that negative effects on trading gains/losses had been relatively restrained as international commodity prices had been stable recently, unlike the situation observed around 2007 and 2008. Many members expressed the recognition that it was important from the viewpoint of achieving sustainable economic growth to generate a virtuous cycle in which the inflation rate gradually rose accompanied by an increase in wages. On this basis, some members said that, while wages per working hour for both full-time and part-time employees had been on a rising trend, they were closely monitoring whether or not the recent improvement in supply and demand conditions in the labor market would lead to a full-scale rise in wages from the second half of fiscal 2013. Meanwhile, one member commented that it was necessary to provide a thorough explanation to the public of the Bank's outlook for economic activity and prices, which incorporated the effects of the scheduled consumption tax hikes.

B. Financial Developments

Members concurred that financial conditions in Japan were accommodative. They shared the view that the monetary base had increased significantly, reflecting the progress in asset purchases by the Bank, and that firms' funding costs had been hovering at low levels. Members agreed that issuing conditions for CP and corporate bonds remained favorable on the whole, as demand from investors continued to be solid, although new issuance of bonds by some firms had been temporarily deferred recently, in response to the rise in long-term interest rates. They also shared the view that firms' credit demand had been increasing moderately, as seen in the fact that the year-on-year rate of increase in the amount outstanding of bank lending had risen somewhat.

With regard to the recent rising trend in stock prices, many members expressed the view that such developments might reflect that the expectations of investors -- who had been risk averse under the deflation that had lasted for nearly 15 years -- were starting to undergo fundamental changes. On this basis, one member added that, although a breakdown by type of investors in the Japanese stock market showed a somewhat one-sided trading pattern -- with overseas investors buying and individual investors in Japan selling -- it was desirable that a wider range of investors support the Japanese stock market as growth expectations for Japan's economy heightened.

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

Based on the above assessment of economic and financial developments, members discussed 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 conduct money market operations so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

With regard to the asset purchases, members concurred that it was appropriate for the Bank to continue with the guidelines decided when it introduced quantitative and qualitative monetary easing at the meeting on April 3 and 4, 2013. Specifically, they confirmed the following. First, the Bank would purchase JGBs so that their amount outstanding would increase at an annual pace of about 50 trillion yen, and the average remaining maturity of the Bank's JGB purchases would be about seven years. Second, it would purchase exchange-traded funds (ETFs) and J-REITs so that their amounts outstanding would increase at an annual pace of about 1 trillion yen and about 30 billion yen, respectively. And third, as for CP and corporate bonds, the Bank would continue with those asset purchases until their amounts outstanding reached 2.2 trillion yen and 3.2 trillion yen, respectively, by end-2013; thereafter, it would maintain those amounts outstanding.

With respect to the future conduct of monetary policy, most members shared the view that the Bank would continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it was necessary to maintain this target in a stable manner. These members continued that, in doing so, it would examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate. In response to this view, one member expressed concern that, in a situation where it seemed difficult to achieve the price stability target in about two years, if a rise were to occur in markets' anticipation that quantitative and qualitative monetary easing would continue for a protracted period or extreme additional measures would be implemented, this could lead to economic instability in the medium to long term, such as through a buildup of financial imbalances. On this basis, this member said that it was appropriate to change the expression representing the Bank's commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter the Bank would review the monetary easing measures in a flexible manner. Counter to this, a few members expressed the view that the current framework did not rule out the possibility of necessary adjustments, and therefore flexibility was sufficiently ensured. One of these members added that it was unclear why the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years in relation to the Bank's commitment to achieving the price stability target.

As for <u>the transmission channels of the effects of quantitative and qualitative monetary easing</u>, one member pointed to the following: (1) upward pressure on consumption from wealth effects; (2) support for business fixed investment through the decline in the expected real cost of capital; and (3) the increase in exports on the back of the depreciation of the yen. This member then expressed the view that these developments had already started to be seen and would gradually lead to a rise in wages and prices through an improvement in supply and demand conditions in the labor market.

Members next discussed <u>developments in the bond market</u>. They agreed that the recent rise in long-term interest rates in Japan was attributable to such factors as the increase in U.S. and European long-term interest rates, the rise in Japanese stock prices, and the further depreciation of the yen. A few members noted that, reflecting speculation that the Federal Reserve would reduce the pace of its asset purchases earlier than expected, the responsiveness of U.S. long-term interest rates to economic indicators was increasing, and therefore due attention should be paid to how these developments would affect Japan's long-term interest rates. On this basis, members shared the recognition that the Bank's massive JGB purchases, through the reduction in risk premia, were restraining upward pressure on interest rates that stemmed from an improvement in perceived business conditions and a pick-up in expected inflation rates. Some members added that the effects of compressing risk premia were likely to strengthen as the Bank proceeded with JGB purchases, and therefore it was difficult to expect a surge in long-term interest rates for the time being. Meanwhile, many members pointed out that, if the bond market remained highly volatile, this could increase the amount of interest rate risk incurred by banks and other financial institutions, thereby further boosting sales of JGBs. These members then expressed the opinion that it was appropriate for the Bank to make various operational adjustments, with a view to encouraging the stable formation of long-term interest rates by suppressing an increase in volatility and an excessive rise in interest rates. Some of these members added that, in deciding quantitative and qualitative monetary easing on April 4, the framework for the Bank's JGB purchases was designed to allow for flexible operations; for example, by allowing the average remaining maturity of its JGB purchases to be in the range of about six to eight years. Based on this discussion, members shared the view that, as for JGB purchases, it was important for the Bank to conduct operations flexibly to promote the permeation of policy effects by adjusting -- as necessary -- the parameters of its JGB purchases, such as frequency, pace, and allocation of purchase amounts by maturities, while continuing to carefully monitor developments in the bond market and maintaining a close dialogue with market participants.

With regard to the relationship between the government's fiscal conditions and long-term interest rates, one member noted that it was essential that fiscal discipline be firmly maintained with a view to ensuring stability in the bond market. In relation to this point, a different member said that it was also important for the Bank to continue to explain thoroughly that its JGB purchases were not conducted for the purpose of financing the fiscal deficit.

Meanwhile, some members pointed out that the recent rise in long-term interest rates in Japan might be attributable to the possibility that the expected period for which short-term interest rates remained virtually zero would shorten to some extent, as the rise in stock prices and the depreciation of the yen progressed and positive developments in economic activity and prices came to be observed. One member added that it was not desirable to shorten the policy duration in a premature manner. A few members, including this member, expressed the view that it was vital for the Bank to firmly anchor short-term interest rates at low levels by clearly communicating that it was providing the monetary base on a large scale through various short-term funds-supplying operations, in addition to JGB purchases. A different member noted that the Bank's communication regarding the timing at which the price stability target would be achieved and the time frame for continuing quantitative and qualitative monetary easing might be destabilizing expectations for the bond market, and this in turn seemed to be increasing volatility. This member continued that, if the Bank were to change the expression representing its commitment by stating that the time frame for continuing quantitative and qualitative monetary easing should be restricted to about two years, and that thereafter it would review the monetary easing measures in a flexible manner, this would contribute to the restoration of stability in the bond market.

IV. Remarks by Government Representatives

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

(1) The government acknowledged that overcoming prolonged deflation was the top-priority task for the Japanese economy. It deemed that the role the Bank's monetary policy had to play in overcoming deflation was extremely important, and expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing and achieve the price stability target of 2 percent at the earliest possible time.

(2) The government would steadily proceed with its efforts toward implementing a flexible fiscal policy, as well as measures for strengthening the growth potential of the Japanese economy. In this regard, the fiscal 2013 budget -- which placed emphasis on measures to revitalize the Japanese economy and to ensure a sense of security in the lives of the people -- had been approved by the Diet on May 15, 2013. Moreover, the government planned to formulate by mid-2013 an ambitious growth strategy including regulatory and institutional reforms. It would do its utmost to implement policy measures in a seamless manner so that the benefits of economic growth would be widely distributed among the public.

(3) Long-term interest rates had risen recently. The government deemed that, if these rates rose considerably above the level consistent with economic recovery, this would exert a significant influence on the Japanese economy and the lives of the people, by adversely affecting firms' funding conditions and increasing the housing-loan burden on households. The government considered that the Bank's large-scale purchases of JGBs under quantitative and qualitative monetary easing could influence the bond market. While the government acknowledged that some time would be required for the market to factor in this influence, it expected the Bank to take appropriate initiatives, including continued thorough communication with the market.

(4) In order to avoid impairing confidence in fiscal sustainability and thereby inducing a surge in long-term interest rates, the government would do its utmost to achieve fiscal consolidation, in particular by steadily formulating a medium-term fiscal plan by mid-2013 to achieve fiscal consolidation targets concurrently with efforts to attain economic revitalization.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy had been picking up slowly. According to the first preliminary estimates of GDP for the January-March quarter released on May 16, 2013, the real GDP rose by 3.5 percent on an annualized quarter-on-quarter basis, registering an increase for the second consecutive quarter. The government deemed that the economic policy effects of the Abe Cabinet had begun to emerge, as evidenced by an increase in private consumption in particular. As for the outlook, the economy was expected to resume its recovery gradually, supported by the improvement in export conditions and the effects of the policy package and monetary policy, as well as the improvement in confidence. Price developments as a whole indicated that, although the economy still remained in a mild deflationary situation, signs of change had been seen in some areas recently.

(2) At the Council on Economic and Fiscal Policy held on May 20, 2013, the government confirmed the progress of the Emergency Economic Measures for the Revitalization of the Japanese Economy. Excluding local public bodies, the proportion of projects -- measured in terms of their number -- for which contracts were concluded with private firms and actual work started had risen further from around 61 percent in April 2013 to around 79 percent in May. The government would continue to steadily manage the progress of the emergency economic measures so that their effects would emerge. Moreover, it would steadily implement the fiscal 2013 budget, which had been approved by the Diet on May 15, 2013. Furthermore, the government would hold active discussions, mainly at the Council on Economic and Fiscal Policy, the Industrial Competitiveness Council, and the Regulatory Reform Council, to formulate by mid-June the Basic Policies for Economic and Fiscal Management, a growth strategy, and a plan to realize regulatory reform.

(3) The government expected the Bank to continue to steadily pursue quantitative and qualitative monetary easing to achieve the price stability target of 2 percent at the earliest possible time. In doing so, the government deemed it important that the Bank respond appropriately to the fluctuations in JGB yields.

(4) In the intensive discussion on monetary policy, prices, and other matters that took place at the Council on Economic and Fiscal Policy held on May 7, 2013, the government confirmed the progress of its policies for the revitalization of the Japanese economy, and Governor Kuroda presented a course toward achieving the 2 percent target. The government would continue to make efforts to ensure steady progress toward achieving the 2 percent target by holding intensive discussions at the Council on Economic and Fiscal Policy. In the meantime, it would scrutinize whether or not the virtuous cycle that led to improvement in the lives of the people would spread throughout the economy.

V. Votes

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, so that the monetary base would increase at an annual pace of about 60-70 trillion yen.

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 conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. A public statement will be decided separately.

Votes for the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, 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

On the basis of the above discussions, members discussed the Statement on Monetary Policy and formed a majority view. One member, however, formulated a proposal, and thus the following two proposals were submitted.

A. Mr. T. Kiuchi's Policy Proposal

With regard to the draft of the statement that formed a majority view, Mr. T. Kiuchi proposed changing the current expression of the Bank's monetary policy stance that "the Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate" to a new expression that "the Bank will aim to achieve the price stability target of 2 percent in the medium to long term. On this basis, it will designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years, and thereafter will review the monetary easing measures in a flexible manner." The proposal was then put to a vote.

The proposal was defeated by a majority vote.

Votes for the proposal: Mr. T. Kiuchi.

Votes against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.

B. The Chairman's Policy Proposal

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

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of April 26, 2013 for release on May 27, 2013.

Attachment

May 22, 2013

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 conduct money market operations so that the monetary base will increase at an annual pace of about 60-70 trillion yen.

2. With regard to the asset purchases, the Bank will continue with the following guidelines:

   a) The Bank will purchase Japanese government bonds (JGBs) so that their amount outstanding will increase at an annual pace of about 50 trillion yen, and that the average remaining maturity of the Bank's JGB purchases will be about seven years.

   b) The Bank will purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at an annual pace of about 1 trillion yen and about 30 billion yen respectively.

   c) As for CP and corporate bonds, the Bank will continue with those asset purchases until their amounts outstanding reach 2.2 trillion yen and 3.2 trillion yen respectively by end-2013; thereafter, it will maintain those amounts outstanding.

3. Japan's economy has started picking up. Exports have stopped decreasing as overseas economies have been moving out of the deceleration phase that had continued since last year and are gradually heading toward a pick-up. Business fixed investment continues to show resilience in nonmanufacturing and appears to have stopped weakening on the whole. Public investment has continued to increase, and housing investment has generally been picking up. Private consumption has seen increased resilience, assisted by the improvement in consumer sentiment. Reflecting these

developments in demand both at home and abroad, industrial production has stopped decreasing and signs of picking up have become increasingly evident. Meanwhile, financial conditions are accommodative. On the price front, the year-on-year rate of change in the consumer price index (CPI, all items less fresh food) has been negative, due to the reversal of the previous year's movements in energy-related and durable consumer goods. Some indicators suggest a rise in inflation expectations.

4. With regard to the outlook, Japan's economy is expected to return to a moderate recovery path, mainly against the background that domestic demand remains resilient due to the effects of monetary easing as well as various economic measures, and that growth rates of overseas economies gradually pick up. The year-on-year rate of change in the CPI is expected to register smaller declines for the time being, and thereafter is likely to gradually turn positive.

5. Regarding risks, there remains a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem and the growth momentum of the U.S. economy as well as the emerging and commodity-exporting economies.

6. The Bank will continue with quantitative and qualitative monetary easing, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner. It will examine both upside and downside risks to economic activity and prices, and make adjustments as appropriate.[Note]

   Such conduct of monetary policy will support the positive movements in economic activity and financial markets, contribute to a rise in inflation expectations, and lead Japan's economy to overcome deflation that has lasted for nearly 15 years.

[Note] Mr. T. Kiuchi proposed that the Bank will aim to achieve the price stability target of 2 percent in the medium to long term and designate quantitative and qualitative monetary easing as an intensive measure with a time frame of about two years. The proposal was defeated by an 8-1 majority vote. Voting for the proposal: Mr. T. Kiuchi. Voting against the proposal: Mr. H. Kuroda, Mr. K. Iwata, Mr. H. Nakaso, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, Mr. K. Ishida, and Mr. T. Sato.