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August 13, 2013

Bank of Japan

Minutes of the Monetary Policy Meeting

on July 10 and 11, 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 Wednesday, July 10, 2013, from 1:59 p.m. to 4:45 p.m., and on Thursday, July 11, from 8:59 a.m. to 11:42 a.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. M. Asakawa, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance

Mr. D. Yamagiwa, Parliamentary Secretary of Cabinet Office, Cabinet Office[2]

Mr. K. Umetani, Vice Minister for Policy Coordination, Cabinet Office[3]

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. Masaki, 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 August 7 and 8, 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. D. Yamagiwa was present on July 11.

3 Mr. K. Umetani was present on July 10.

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. R. Hattori, 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 June 10 and 11, 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 157-174 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 at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills) had been somewhat below the 0.1 percent level for all maturities. Rates on longer-term interbank instruments had been flat.

With regard to long-term interest rates, yields on 10-year JGBs had generally been more or less flat under the Bank's flexible conduct of outright purchases of JGBs, although they had temporarily risen somewhat following the substantial rise in U.S. long-term interest rates reflecting speculation about the direction of U.S. monetary policy. The Nikkei 225 Stock Average had temporarily dropped sharply following the fall in U.S. stock prices -- reflecting speculation about the direction of U.S. monetary policy -- and weaker-than-expected Chinese economic indicators, but then rose to above the level reached at the start of the intermeeting period, partly due to a positive response to the yen's depreciation. Prices for Japan real estate investment trusts (J-REITs) had been rising. Yield spreads 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. In the foreign exchange market, the yen had temporarily appreciated against the U.S. dollar, with the rate entering the range of 93-94 yen following the substantial decline in Japanese stock prices, but then depreciated again in response to speculation about the direction of U.S. monetary policy.

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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.

C. Overseas Economic and Financial Developments

As for overseas economies, while the manufacturing sector continued to show a lackluster performance, they were gradually heading toward a pick-up as a whole.

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. Although effects of the expiration of the payroll tax cut continued to be observed, private consumption remained on a moderate increasing trend as the employment situation followed an improving trend and asset prices rose. Housing investment also continued to pick up. Exports were emerging from a leveling-off phase. On the other hand, federal government expenditures -- particularly federal defense spending -- had been declining. This had caused the business sentiment of some firms -- particularly in defense-related industries -- to turn cautious, and the pace of pick-up in production and business fixed investment to slow. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less food and energy, or the core CPI, had been more or less flat at a relatively low level. In this situation, the year-on-year rate of increase in the CPI for all items had risen somewhat, mainly as a result of the slowing of the year-on-year rate of decline in energy prices.

Economic activity in Europe continued to recede slowly. Exports had bottomed out and production had been heading for a bottom. Further deterioration in business and household sentiment had come to a halt, and some signs of improvement had started to be observed. Nevertheless, both business fixed investment and private consumption had been declining, partly due to continuing fiscal austerity. As for prices, while slack in supply and demand conditions had been exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items excluding energy and unprocessed food was on a declining trend. The HICP for all items, on the other hand, had risen somewhat, reflecting the fact that the year-on-year rate of change in energy prices had turned positive. Meanwhile, economic activity in the United Kingdom was heading toward a pick-up.

With regard to Asia, the Chinese economy continued to see stable growth, albeit at a relatively low level, as the government engaged in a variety of reforms. Private consumption had been firm on the back of a favorable employment and income situation, although effects of the government's frugality campaign continued to be observed in some areas. The pace of increase in fixed asset investment had been solid, mainly due to rises in infrastructure investment and real estate investment. The underlying trend in exports was heading toward a pick-up, although some weakness had been observed. Production growth continued to be stable supported by firm domestic demand, despite effects of inventory adjustments in materials industries -- iron and steel in particular. The underlying trend in prices had been stable. 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. Private consumption had been firm, especially in the ASEAN countries, where the employment and income situation remained favorable. Nevertheless, moves toward a pick-up in both exports and production had come to a pause, with some weakness in exports continuing to be observed in a few regions. Growth in business fixed investment had been sluggish, as business sentiment still remained cautious, particularly in the NIEs. As for prices, inflation rates had generally been declining, although there were regional differences. In India, the economy remained in a state of deceleration.

In global financial markets, speculation among investors about the direction of U.S. monetary policy -- namely, that the Federal Reserve would reduce the pace of its asset purchases earlier than expected -- heightened further. Under these circumstances, in the bond market U.S. Treasury yields had risen significantly, affecting a number of regions and thereby causing longer-term interest rates to rise worldwide. Outflows of funds also were observed from the high-yield bond markets and REIT markets, into which funds had previously continued to flow. In emerging markets, there were outflows of funds reflecting the aforementioned speculation as well as reduced expectations for a strong economic expansion in the emerging economies, resulting in simultaneous declines in stock prices and bond prices as well as a depreciation in foreign exchange rates. The increased volatility worldwide was also leading investors to temporarily refrain from investing in financial assets other than those with relatively short maturities. Meanwhile, international commodity prices had fallen, especially for precious metals and nonferrous metals, partly on the back of China's weaker economic outlook.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had been picking up. Real exports had turned upward in the January-March quarter of 2013 and kept increasing in the April-May period relative to that quarter, after having continued to decline in the July-September and October-December quarters of 2012. Exports of motor vehicles and their related goods -- due in part to the effects of developments in foreign exchange rates -- had resumed an uptrend, assisted by a pick-up in those to China -- which had seen a significant drop -- while those to the United States and other regions had been steady. Exports of capital goods and parts as a whole had recently started to bottom out, with upward movements observed in exports to the United States and East Asia, disregarding the fluctuations in ships. Exports of IT-related goods as a whole appeared to be heading for a bottom, with the effects of the downshift in demand for parts for final products of smartphones -- which had taken place since the end of 2012 -- easing. Exports were expected to increase moderately, mainly against the background of the pick-up in overseas economies.

Public investment continued to increase. It was expected to continue trending upward, supported by the effects of various economic measures.

Business fixed investment had stopped weakening and shown some signs of picking up as corporate profits had improved. Meanwhile, business sentiment had been improving. In the June 2013 *Tankan* (Short-Term Economic Survey of Enterprises in Japan), the diffusion index for business conditions for all industries and enterprises (the proportion of firms responding that business conditions were "favorable" minus the proportion of those responding that they were "unfavorable") was in negative territory, but had noticeably risen, marking the highest level in five and a half years. Business fixed investment was projected to follow a moderate increasing trend, partly due to investment related to disaster prevention and energy, as corporate profits continued to improve. Business fixed investment plans (excluding software investment and including land purchasing expenses) for fiscal 2013 in the June *Tankan* had been revised upward from the March *Tankan* for all industries and enterprises, and registered a year-on-year increase of 2.0 percent.

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

Private consumption remained resilient, assisted by the improvement in consumer sentiment. Sales at department stores had been firm, notably in imports and high-end products, as they had climbed through the January-March quarter and had been more or less flat in the April-May period compared with that quarter. Sales in the food service industry as a whole had been steady, and had recently shown some strength. Private consumption was expected to remain resilient, supported in part by improvement in the employment situation.

The pick-up in housing investment had become evident, and such investment was expected to increase.

Reflecting these developments in demand both at home and abroad, industrial production was increasing moderately. On a quarterly basis, it had turned upward -- albeit marginally -- in the January-March quarter of 2013, and accelerated its pace of increase in the April-May period relative to that quarter, after having declined for three quarters in a row since the April-June quarter of 2012. Industrial production was expected to continue increasing moderately, 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, and although uncertainty remained, it was likely to continue rising in the July-September quarter.

As for prices, the three-month rate of increase in the domestic corporate goods price index (CGPI) was declining against the backdrop of movements in international commodity prices and foreign exchange rates. The CGPI was expected to rise moderately for the time being. The year-on-year rate of change in the CPI (all items less fresh food) was currently 0 percent and likely to turn positive. Meanwhile, in regard to inflation expectations, although the rise in some market indicators had come to a pause, considering the results of surveys conducted on firms, households, and economists -- including the diffusion index for output prices in the June *Tankan* -- indicators suggested a rise in such expectations on the whole.

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 at around 35 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. 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 had been at around 2 percent. 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 3.5-4.0 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 the further heightening of speculation that the Federal Reserve would reduce the pace of its asset purchases earlier than expected had led to a rise in longer-term interest rates worldwide, particularly in the U.S. and European economies, and to outflows of funds from emerging economies. Some members expressed the view that the Federal Reserve's intention -- namely, to decide on a possible reduction in asset purchases depending on economic developments -- might not have permeated the markets sufficiently. They continued that it was therefore possible that speculation about the direction of U.S. monetary policy would continue to have an impact on global financial markets. One of these members noted that, while the Federal Reserve emphasized that the stock (the amount outstanding of assets purchased) would be maintained at a high level, the markets were instead responding to a possible reduction in the flow (the amount of assets to be purchased). With regard to the outflows of funds from emerging markets, some members expressed the recognition that it was necessary to continue to carefully monitor developments in the flow of funds and their effects, taking into account experience gained from similar cases in which outflows of funds had affected economic developments in emerging economies. One of these members noted that the main scenario was that the markets were likely to gradually regain stability as the Federal Reserve's aforementioned intention permeated them.

Furthermore, one member expressed the view that the impact of such outflows would not be as significant as in past cases considering that the local currency-denominated bond markets had been developing in emerging economies, particularly those in Asia. Meanwhile, a few members said that, given that a steady recovery in the U.S. economy was a prerequisite for slowing the pace of asset purchases, the recovery itself was a positive development for the world economy, including emerging economies.

Members concurred that, while the manufacturing sector continued to show a lackluster performance, overseas economies were gradually heading toward a pick-up as a whole. One member added that attention should be paid to the possibility that the pick-up in overseas economies had fallen off recently, as seen in the somewhat conspicuous weakness in Europe and emerging economies. As for the outlook, members shared the recognition that overseas economies would gradually pick up as downward pressure from the fiscal side was reduced in Europe and the United States, and as business sentiment improved.

Members agreed 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 noted that the mechanism for a self-sustained recovery appeared to be strengthening on the whole amid solid improvement in such areas as the employment situation, disposable income, and the personal saving rate. As for the outlook, members concurred that, although there would be downward pressure from the fiscal side for the time being, the economy was likely to continue recovering at a moderate pace supported in part by accommodative financial conditions. However, some members expressed the recognition that it was necessary to pay attention to the effects of the recent rise in long-term interest rates on, for example, housing investment. One of these members added that, if expected inflation rates were anchored, a rise in nominal interest rates would push up real interest rates. The member continued that whether the rate of return on investment was high enough to offset the rise in real interest rates would therefore be the key to assessing the pace of U.S. economic recovery.

Members shared the recognition that economic activity in the euro area continued to recede slowly. As for the outlook, they concurred that this situation would continue for the immediate future but the economy would gradually show signs of bottoming out --

triggered by an improvement in economic entities' sentiment and the pick-up in exports -- as additional downward pressure from the fiscal side was reduced. A few members expressed the view that exports to outside the area had bottomed out and signs of improvement in business and consumer sentiment had been observed recently. One member noted that the provision of forward guidance by the European Central Bank (ECB) was expected to prevent unintended rises in interest rates and destabilization of financial markets, thereby reducing downside risks to the European economy.

Members agreed that the Chinese economy continued to see stable growth, albeit at a relatively low level, as the government engaged in a variety of reforms. As for the outlook, they shared the view that domestic demand would remain firm, mainly on the back of a favorable employment and income situation. They concurred that, nevertheless, the economy was less likely to return to a high growth path as seen in the past, considering, for example, that the government's policy emphasized "quality-based" growth and targeted well-balanced growth. A few members expressed the view that, for the time being, it was likely that external demand would be weak and inventory adjustment pressures would persist. Many members noted that the Chinese authorities had been clarifying their stance to correct the overly rapid credit expansion, which included addressing the issue of shadow banking. A few of these members expressed the opinion that the rise in short-term interest rates toward end-June could be explained in this context.

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 gradually as exports to advanced economies picked up moderately.

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

Most members expressed the view that the economy was starting to recover moderately since, in the corporate sector, a virtuous cycle from income to spending appeared to have gradually started operating as the level of economic activity had been rising moderately on the back of the resilience in domestic demand together with the pick-up in exports. In response to this view, one member -- although largely in agreement with this economic assessment -- noted that some more time should be taken to determine whether the word "recovery" was appropriate in describing the current economic situation, given the uncertainty regarding overseas economies and the fact that economic indicators that had recently exhibited improvement largely comprised diffusion indices and figures in business plans. Meanwhile, a few members expressed the view that it was appropriate to provide an economic assessment that Japan's economy was starting to recover moderately, since various economic indicators were at fairly high levels and the virtuous cycle appeared to have started operating. A different member expressed the recognition that, in view of the improvements in the *Tankan* and the output gap, for example, economic activity seemed to have risen to a level nearly equivalent to that during past economic recovery phases. Based on this discussion, members shared the assessment that Japan's economy was starting to recover moderately.

Specifically, members shared the recognition that, as the U.S. economy recovered moderately, exports had been picking up, underpinned partly by developments in foreign exchange rates. They concurred that business fixed investment had stopped weakening and shown some signs of picking up as corporate profits had improved. One member expressed the view that, judging from coincident indicators, it was possible that business fixed investment -- which had been lagging behind so far -- had started to pick up from the April-June quarter of 2013. Members shared the recognition that private consumption remained resilient, assisted by the improvement in consumer sentiment. As the main factor behind the resilience in private consumption, one member pointed to wealth effects stemming largely from the rise in stock prices. A different member noted that the *Current Survey of Commerce* showed that sales across many types of businesses had turned positive on a year-on-year basis. Meanwhile, one member -- noting that the *Family Income and Expenditure Survey* for April and May 2013 suggested a waning in momentum for private consumption observed since the start of the year, and that car sales had recently been slowing -- expressed the view that the sustainability of the resilience in private consumption warranted attention. Members agreed that the pick-up in housing investment had become evident. They shared the view that industrial production was increasing moderately, reflecting the fact that exports had been picking up while domestic demand remained resilient.

As for <u>the outlook for the economy</u>, members shared the view that the economy was likely to recover moderately on the back of the resilience in domestic demand and the pick-up in overseas economies. On this point, many members noted that, according to the June 2013 *Tankan*, business sentiment was clearly improving across a wider range of industries. On this basis, they expressed the recognition that firms' business plans for fiscal 2013 indicated that firms were planning to steadily increase fixed investment in view of improvement in the sales and profit outlook, which suggested that improvements in business sentiment and corporate profits were beginning to facilitate actual spending. In response to this view, one member expressed the opinion that business fixed investment plans of large manufacturing firms lacked strength in terms of their year-on-year rates of increase and revision rates, and pointed out that firms continued to prioritize fixed investment overseas over that in Japan. Many members noted that a key factor to bear in mind when assessing the sustainability of economic recovery was whether the recovery would lead to an improvement in the income situation. In relation to this point, one member expressed the recognition that employee incomes had started to rise, as the number of employees had been increasing recently at a time when wages per worker had stopped declining. A few members said that positive signs had begun to be observed in areas such as summer bonus payments. Nevertheless, one of these members added that such developments were limited to some large firms, and therefore it remained unclear whether they would spread throughout the corporate sector, including small firms.

Regarding <u>prices</u>, members concurred that the year-on-year rate of change in the CPI (all items less fresh food) was currently 0 percent and likely to turn positive. One member pointed out that price rises had been increasing gradually at each stage of the distribution process. A different member expressed the view that signs of a change in firms' price-setting behavior had been observed, including the introduction of higher-end products and services in some areas within the food service industry. Meanwhile, a few members expressed the recognition that the year-on-year rate of increase in the CPI would rise until around summer 2013, due in part to the reversal of the previous year's decline in energy prices, and that the rise might come to a pause thereafter. One of these members continued to closely monitor whether factors specific to Japan could lead to a rise in the rate of increase in the CPI, amid the global disinflationary trend. As for inflation expectations, members shared the recognition that, although the rise in some market indicators had come to a pause, considering the results of surveys conducted on firms, households, and economists -- including the diffusion index for output prices in the June 2013 *Tankan* -- indicators suggested a rise in such expectations on the whole. One member expressed the view that it remained difficult to identify the effects of perceptions regarding the likelihood of the consumption tax hikes on developments in these indicators. A different member pointed out that, according to the Bank's *Opinion Survey on the General Public's Views and Behavior*, the proportion of respondents who expected that prices "will go up" one year from the time of the survey had increased to about 80 percent.

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 firms continued to see financial institutions' lending attitudes as being on an improving trend and that issuing conditions for CP and corporate bonds remained favorable on the whole. They also concurred 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 been at around 2 percent and the year-on-year rate of change in the amount outstanding of CP and corporate bonds had been positive.

C. Interim Assessment

Given the above assessment of recent developments, members agreed that the economy was likely to continue growing at a pace above its potential, as a trend, broadly in line with the forecasts in the baseline scenario presented in the April 2013 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), although the balance between domestic and overseas demand had changed slightly -- such that domestic demand was likely to be somewhat stronger while overseas demand would probably be somewhat weaker than projected. Some members attributed the latter to a weakening in overseas economies, especially the Chinese economy and emerging and commodity-exporting economies. One member expressed the recognition that it had become more likely that the timing of a pick-up in overseas economies would be delayed, considering the recent turmoil in emerging markets and Chinese authorities' policy stance to contain credit expansion while tolerating an economic deceleration for the time being. On the other hand, a different member said that, given that U.S. real imports had registered relatively high growth in the April-May period compared with the January-March quarter of 2013, exports to the United States would likely continue to underpin external demand by offsetting weakness in those to other regions.

With regard to the forecasts of prices in the baseline scenario, members shared the view that the forecasts for the year-on-year rate of change in the CPI (all items less fresh food) were broadly in line with those presented in the April 2013 Outlook Report. Most members were of the view that the year-on-year rate of change in the CPI was likely to follow a rising trend, reflecting factors such as the improvement in the aggregate supply and demand balance as well as the rise in medium- to long-term inflation expectations, and that it was likely to reach around 2 percent -- the price stability target -- toward the latter half of the projection period, spanning from fiscal 2014 through fiscal 2015. One member expressed the recognition that an increase in base salary would play a significant role in changing people's expectations and shifting the Phillips curve upward. As was the case when the April 2013 Outlook Report had been discussed, a few members held a more cautious view of the outlook for prices compared with the forecasts in the baseline scenario, mainly because it seemed highly uncertain whether changes in inflation expectations would lead to a rise in the actual rate of inflation. These members added that developments in scheduled cash earnings, which would be the key to assessing future price developments, had been somewhat weak so far. Moreover, one member said that, when incorporating the effects of the scheduled consumption tax hikes, the inflation rate for fiscal 2014 was likely to substantially exceed the 2 percent price stability target. This member was therefore closely monitoring whether such effects would be sufficiently factored into short-term inflation expectations.

As for risks to the outlook, members shared the recognition that there remained a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem, developments in the emerging and commodity-exporting economies, and the pace of recovery in the U.S. economy. One member pointed to the recent political turmoil observed in Portugal and Greece as risks concerning the prospects for the European debt problem. With respect to developments in the emerging and commodity-exporting economies, some members said that attention should be paid to a reversal in the global flow of funds caused by speculation about the direction of U.S. monetary policy and the possibility of a deceleration in the pace of Chinese economic growth due to a change in the Chinese authorities' policy stance. A few of these members added that, while it was considered that the Chinese authorities' policy stance that placed priority on achieving "quality-based" growth would contribute to the stability of the global economy over the long term, it would pose downside risks to Chinese economic growth over the short term. With regard to the pace of recovery in the U.S. economy, one member expressed the view that the risk of a deceleration appeared to have increased, considering, for example, the effects of the fiscal drag and possible effects on the economy in the event of an economic slowdown in emerging economies resulting from the reversal in the global flow of funds. On the other hand, a different member pointed out that, in the United States, monetary easing effects arising from the maintenance of exceptionally low interest rates could strengthen further amid an improvement in perceived economic conditions.

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, for CP and corporate bonds, the Bank would continue with these asset purchases until their amounts outstanding reached 2.2 trillion yen and 3.2 trillion yen, respectively, by end-2013; thereafter, it would maintain these 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 for maintaining 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. In response to this, a few members said that such a change in the expression representing the Bank's commitment could lead to the unintended consequence of weakening monetary easing effects. One of these members added that it was important, first of all, that the Bank secure market confidence in monetary policy through a steady accumulation of the easing effects. This member also said that the Bank should continue to communicate with the public to raise further understanding of its commitment to continuing with quantitative and qualitative easing until it was able to maintain the price stability target of 2 percent in a stable manner. One member pointed out that the Bank had made clear that it intended to examine risks, including those stemming from the accumulation of financial imbalances, and make adjustments as appropriate under the current framework of quantitative and qualitative monetary easing.

With regard to the effects of quantitative and qualitative monetary easing, members shared the recognition that these were firmly taking hold, and financial conditions were easing steadily to underpin firms' and households' spending. They agreed that, in this situation, there was a wider range of positive movements in economic activity and financial markets, and people's expectations for economic activity and prices had turned favorable. One member said that a steady improvement in economic activity and prices was in sight, as seen in the results of surveys that indicated a gradual rise in inflation expectations, reflecting the expected improvement in economic activity.

With regard to how much of an effect could be exerted on longer-term interest rates, many members noted that long-term interest rates in Japan had been stable amid the rise in interest rates that had been observed worldwide since mid-June 2013. On this basis, these members commented that the Bank's massive JGB purchases, by compressing risk premiums, were significantly restraining upward pressure on long-term interest rates that stemmed from the rise in overseas interest rates and an improvement in perceived business conditions. As for liquidity in the bond market, a few members pointed out that the ratio of the daily price range to the transaction volume in the JGB futures market remained at a relatively high level. One of these members added that there was a possibility that this factor might have been reflected in liquidity premiums and was being added on to interest rates. One member said that potential instability remained in the bond market, and the effects of developments in domestic prices and U.S. interest rates warranted attention. Many members expressed the view that it was important that the Bank continue to encourage the stable formation of interest rates by engaging in thorough communication with the market and conducting market operations flexibly. In relation to this, some members expressed the opinion that it also was important that the credibility of fiscal management be maintained in order to ensure the stability of interest rates, and therefore expected the government to steadily promote measures aimed at achieving fiscal consolidation. Meanwhile, one member pointed out that, if there were overly heightened expectations that the Bank would keep interest rates stable at low levels by purchasing JGBs, this might lead to (1) an accumulation of global financial imbalances through such factors as an increase in investment to emerging economies using funds raised in the Japanese market, and (2) a weakening of the government's stance in terms of its efforts to achieve fiscal consolidation.

With regard to effects brought about through fundamental changes in economic entities' expectations, many members expressed the view that, in a situation where nominal interest rates had been stable, real interest rates were declining on the back of a rise in inflation expectations. As for the outlook, one of these members added that a rise in inflation expectations and an accompanying decline in real interest rates would progress further, as inflation expectations were in the process of rising toward 2 percent.

As for firms' and households' funding activities, many members pointed out that there was a wider range of positive movements that made use of accommodative financial conditions, as evidenced by the following: (1) the amount of corporate bonds issued in the April-June quarter of 2013 had reached its highest level since the Lehman shock; (2) the year-on-year rate of increase in the amount outstanding of bank lending had risen; and (3) equity financing had increased. One of these members expressed the view that major banks' lending stance was becoming active. A different member added that funding by firms and households was expected to become more active. Many members noted that, under these circumstances, the year-on-year rate of growth in the money stock had risen to the range of 3.5-4.0 percent. One of these members expressed the opinion that an increase in the money stock would lead to a rise in the actual rate of inflation, which would in turn induce a rise in inflation expectations. One member expressed the view that the portfolio rebalancing effect would gradually permeate the economy as quantitative and qualitative monetary easing progressed and the outstanding balance of current accounts at the Bank accumulated further. Meanwhile, a few members noted that it would take some time for financial institutions to rebalance their large JGB holdings, due in part to various regulations and constraints in terms of risk management. One of these members added that the "portfolio rebalancing effect" in a broad context -- by which a wide range of economic entities would be encouraged to take on risks due to rises in inflation expectations and growth expectations -- had begun to materialize to some extent. This member continued that, in order for this effect to fully take hold, it was important that the government proceed with its regulatory and institutional reforms as well as measures for strengthening the growth potential of Japan's economy.

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. The government understood that the discussion at this meeting on the Bank's interim assessment of the April 2013 Outlook Report confirmed the steady progress of the Japanese economy toward achieving the price stability target of 2 percent.

Furthermore, it 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 joint statement by the government and the Bank released on January 22, 2013 clearly indicated their respective roles in overcoming deflation and achieving sustainable economic growth. In line with this statement, the government would play its role in a responsible manner. In this regard, the Cabinet had recently decided the Japan Revitalization Strategy, which aimed at unleashing the power of the private sector to the fullest extent, as well as the Basic Policies for Economic and Fiscal Management and Reform (hereafter the Basic Policies), which aimed at creating a virtuous cycle of economic revitalization and fiscal consolidation. The government would swiftly and steadily implement these initiatives.

(3) Although large fluctuations in long-term interest rates had not been observed recently, there remained concern that even a small shock might trigger an increase in market volatility in a situation where liquidity in the JGB market had been declining. The government acknowledged that the Bank had taken vigorous actions under these circumstances, such as making flexible adjustments to the method of purchasing JGBs in view of market participants' opinions. The government expected the Bank to continue to conduct market operations flexibly, taking account of market developments, and to fully communicate this stance to the public at home and abroad.

(4) The government would continue to monitor financial market developments closely. Moreover, in order to avoid impairing confidence in fiscal sustainability and thereby inducing a surge in long-term interest rates, it would do its utmost to achieve fiscal consolidation by making such efforts as formulating by mid-2013 a medium-term fiscal plan -- based on the Basic Policies -- to attain fiscal consolidation targets concurrently with efforts toward economic revitalization.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy had been picking up steadily. As for the outlook, the recovery was expected to resume as the improvement in corporate profits led to increases in household income and business investment, while exports picked up and the effects of a range of policies developed. 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, such as an increase in the proportion of households expecting a rise in prices and that of firms anticipating a rise in output prices.

(2) The government confirmed the progress of the emergency economic measures at the Council on Economic and Fiscal Policy held on June 13, 2013; the proportion of national and local government projects -- measured in terms of their number -- for which actual work had started was around 81 percent. On June 14, the Cabinet decided the Basic Policies, the Japan Revitalization Strategy, and the Regulatory Reform Work Plan. In the Basic Policies, the government had set forth its aim regarding the primary balance of national and local governments: namely, to reduce the ratio of fiscal deficit to GDP by half by fiscal 2015, compared with that for fiscal 2010, achieve a surplus by fiscal 2020, and thereafter reduce the ratio of government debt to GDP in a stable manner. To this end, it presented its basic stance for the prioritizing and streamlining of major expenditure items including social security, social infrastructure development, and local public finance. The government would formulate a medium-term fiscal plan in August. In addition, based on the Japan Revitalization Strategy, it would move forward with the implementation of policies that would draw out the vitality of the private sector and create new market frontiers, working to ensure that the Japanese economy remained on track for robust growth. Moreover, it would steadily carry out the Regulatory Reform Work Plan, which laid out the following as its five priority areas: energy and environment; childcare; health and medicine; employment; and setting up a new business.

(3) The government expected the Bank to achieve the price stability target of 2 percent, in line with the Bank's interim assessment of the April 2013 Outlook Report discussed at this meeting. It also expected the Bank to continue providing a sufficient explanation on the state of its monetary policy conduct and its outlook for prices at the Council on Economic and Fiscal Policy and on other occasions. The government acknowledged that the Bank had taken appropriate initiatives in response to the temporary increase in market volatility through communication with the market.

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 future 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 June 10 and 11, 2013 for release on July 17, 2013.

Attachment

July 11, 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 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 is starting to recover moderately. As for overseas economies, while the manufacturing sector continues to show a lackluster performance, they are gradually heading toward a pick-up as a whole. In this situation, exports have been picking up. Business fixed investment has stopped weakening and shown some signs of picking up as corporate profits have improved. Public investment has continued to increase, and the pick-up in housing investment has become evident. Private consumption has remained resilient, assisted by the improvement in consumer sentiment. Reflecting these developments in demand both at home and abroad, industrial production is increasing moderately. Business sentiment has been improving. 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) is currently 0 percent. Some indicators suggest a rise in inflation expectations.

4. With regard to the outlook, Japan's economy is expected to recover moderately on the back of the resilience in domestic demand and the pick-up in overseas economies. The year-on-year rate of change in the CPI is likely to turn positive.

5. Compared with the forecasts presented in the April 2013 *Outlook for Economic Activity and Prices*, the growth rate and year-on-year rate of change in the CPI will likely be broadly in line with the April forecasts.

6. Regarding risks, there remains a high degree of uncertainty concerning Japan's economy, including the prospects for the European debt problem, developments in the emerging and commodity-exporting economies, and the pace of recovery in the U.S. economy.

7. 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 the 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.

(Appendix 1)

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2013	+2.5 to +3.0 [+2.8]	+0.5 to +0.8 [+0.6]	
Forecasts made in April 2013	+2.4 to +3.0 [+2.9]	+0.4 to +0.8 [+0.7]	
Fiscal 2014	+0.8 to +1.5 [+1.3]	+2.7 to +3.6 [+3.3]	+0.7 to +1.6 [+1.3]
Forecasts made in April 2013	+1.0 to +1.5 [+1.4]	+2.7 to +3.6 [+3.4]	+0.7 to +1.6 [+1.4]
Fiscal 2015	+1.3 to +1.9 [+1.5]	+1.6 to +2.9 [+2.6]	+0.9 to +2.2 [+1.9]
Forecasts made in April 2013	+1.4 to +1.9 [+1.6]	+1.6 to +2.9 [+2.6]	+0.9 to +2.2 [+1.9]

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

2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

3. Individual Policy Board members make their forecasts assuming the effects of past policy decisions and with reference to views incorporated in financial markets regarding future policy.

4. The scheduled consumption tax hikes for April 2014 and October 2015 -- to 8 percent and 10 percent, respectively -- are incorporated in the forecasts. In terms of the outlook for the CPI, individual Policy Board members make their forecasts based on figures excluding the direct effects of the consumption tax hikes.

5. The forecasts for the CPI for fiscal 2014 and fiscal 2015 that incorporate the direct effects of the consumption tax hikes are constructed as follows. First, the contribution to prices from each tax hike is mechanically computed on the assumption that the tax increase will be fully passed on for all taxable items. The CPI for fiscal 2014 and fiscal 2015 will be pushed up by 2.0 percentage points and 0.7 percentage point, respectively. Second, these figures are added to the forecasts made by the Policy Board members.

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

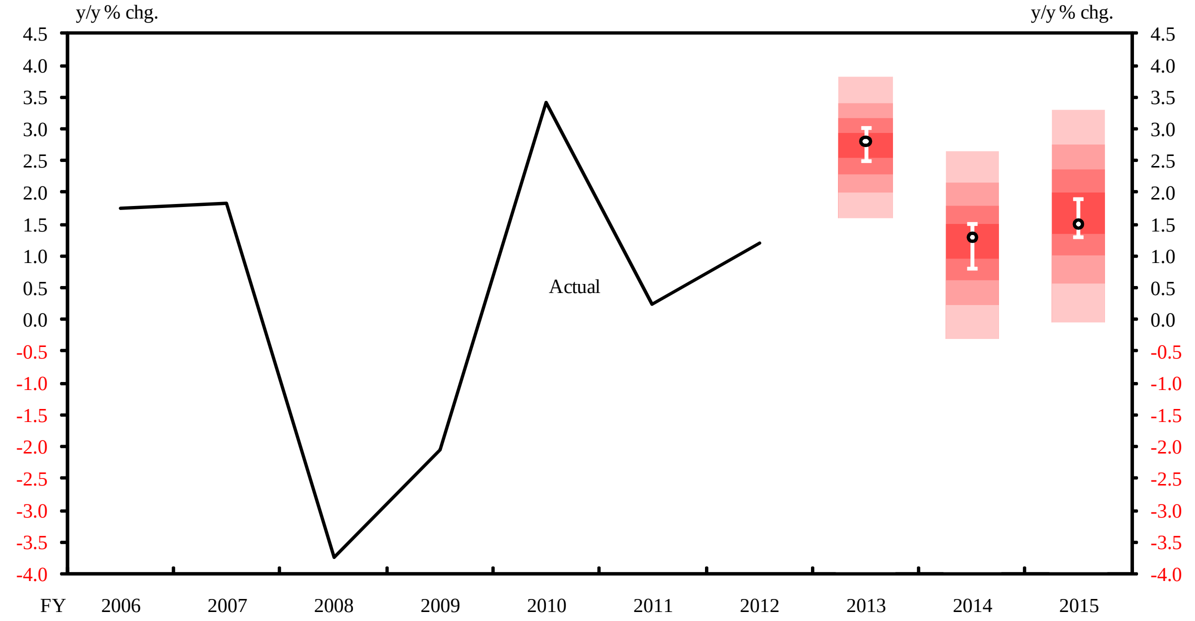
y/y % chg.

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hikes
Fiscal 2013	+2.3 to +3.0	+0.4 to +1.0	
Forecasts made in April 2013	+2.1 to +3.1	+0.4 to +1.0	
Fiscal 2014	+0.4 to +1.5	+2.6 to +3.7	+0.6 to +1.7
Forecasts made in April 2013	+0.6 to +1.7	+2.6 to +3.7	+0.6 to +1.7
Fiscal 2015	+1.2 to +2.1	+1.4 to +3.0	+0.7 to +2.3
Forecasts made in April 2013	+1.3 to +2.1	+1.5 to +3.0	+0.8 to +2.3

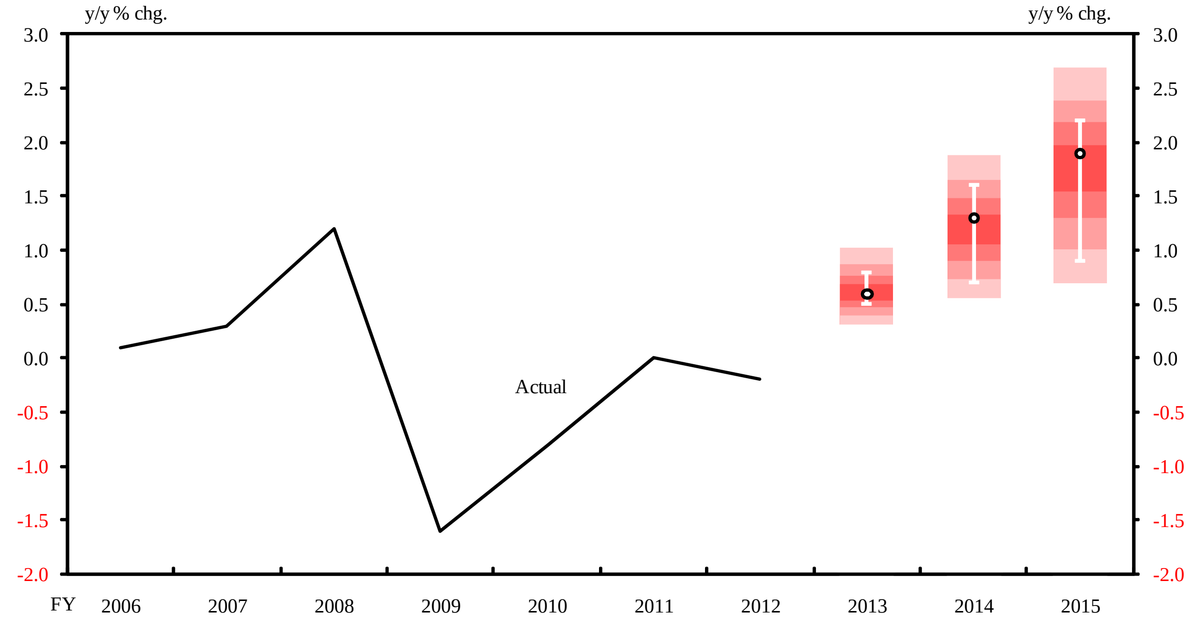
(Appendix 2)

Forecast Distribution Charts of Policy Board Members

(1) Real GDP



(2) CPI (All Items Less Fresh Food)



Notes: 1. Based on the aggregated probability distributions (i.e., the Risk Balance Charts) compiled from the distributions of individual Policy Board members, the Forecast Distribution Charts are compiled as follows. First, upper and lower 10 percentiles of the aggregated distributions are trimmed and second, colors indicated below are used to show the respective percentiles of those distributions.

Upper 40% to lower 40%	Upper 30 to 40% & lower 30 to 40%	Upper 20 to 30% & lower 20 to 30%	Upper 10 to 20% & lower 10 to 20%

2. For the process of compilation of the Risk Balance Charts, see the box on page 9 of the April 2008 *Outlook for Economic Activity and Prices* .

3. The circles in the bar charts indicate the median of the Policy Board members' forecasts (point estimates). The vertical lines in the bar charts indicate the range of the forecasts of the majority of Policy Board members.

4. The forecast for the CPI excludes the direct effects of the scheduled consumption tax hikes.