

Monetary Policy

I. Summary

II. Economic and Financial Developments in Fiscal 2006

III. Monetary Policy in Fiscal 2006

IV. Revisions of Monetary Policy Tools

- A. Introduction of Funds-Supplying Operations against Pooled Collateral
- B. Amendment of Margin Tables for Eligible Collateral
- C. Amendment of Guidelines on Eligible Collateral to Reflect the Dissolution of the Government Housing Loan Corporation

I. SUMMARY

The Bank of Japan decides and implements monetary policy.

The Bank's monetary policy is aimed at contributing to the sound development of the national economy through the pursuit of price stability, as stipulated in Article 2 of the Bank of Japan Law.

The Law stipulates that monetary policy shall be decided by the Policy Board at Monetary Policy Meetings (MPMs).

Money market operations—the Bank's day-to-day provision and absorption of funds in the market—are carried out based on the guideline decided at each MPM. Monetary policy aims at achieving price stability through these operations, thereby contributing to the sound development of the national economy.

The Bank held 14 MPMs in fiscal 2006. (For the guidelines for money market operations decided at these MPMs, see Table 1.)

II. ECONOMIC AND FINANCIAL DEVELOPMENTS IN FISCAL 2006

Japan's economy continued to expand moderately, with a virtuous circle of production, income, and spending in operation.

Exports continued to increase, reflecting the expansion of overseas economies. Business fixed investment also continued to increase against the background of high corporate profits. Meanwhile, public investment was basically on a downtrend.

Looking at the employment and income situation, household income rose moderately as various indicators continued to show tighter labor market conditions. In this situation, private consumption was firm, although it was temporarily sluggish around the summer due partly to unfavorable weather. Housing investment increased moderately with some fluctuations.

Production continued to increase against the back-

ground of the growth in domestic and external demand.

As for prices, domestic corporate goods prices increased in the first half of fiscal 2006, mainly reflecting the rise in international commodity prices, but were somewhat weak or flat in the second half of the fiscal year due to the drop in international commodity prices. The year-on-year rate of change in consumer prices (excluding fresh food) registered small increases through the second half of 2006; from the beginning of 2007 onward it was around 0 percent due to the drop in crude oil prices.

The Policy Board members' assessment of the economic and financial situation is expressed in "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments*. The opening sentences of "The Bank's View" for each month released in fiscal 2006 are listed in Table 2.¹

1. "The Bank's View" is decided at the first MPM of each month and constitutes the Bank's basic view of economic and financial conditions. It is used as the basis of subsequent monetary policy decisions.

The Bank also published its assessments of economic activity and prices and provided Policy Board members' forecasts of economic growth and inflation as reference figures in "The Bank's View" of the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), after deciding the text at the MPMs held on April 28 and October 31, 2006. In line with the new framework for the conduct of monetary policy introduced on March 9, 2006, the Bank assessed economic activity and prices from two perspectives and outlined its views on the

future course of monetary policy in the two issues of the Outlook Report published in fiscal 2006.

Furthermore, the Bank made interim assessments of the outlook laid out in these two publications at separate MPMs on July 13 and 14, 2006, and also on January 17 and 18, 2007. These interim assessments were published in "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments*. The text of these publications is available on the Bank's web site.

III. MONETARY POLICY IN FISCAL 2006

At the four MPMs held during the period from April 10 and 11 to June 14 and 15, 2006, the Bank decided to maintain its guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at effectively 0 percent.

At the MPM on July 13 and 14, 2006, the Bank's assessment was that, with steady improvements in economic activity and prices broadly in line with the projection presented in the April 2006 Outlook Report, the stimulus from monetary policy had been gradually amplified, and that maintaining the zero interest rate environment might result in large swings in economic activity and prices in the future. The Bank therefore judged it appropriate to adjust the level of the policy interest rate at this meeting so that a desirable course of economic activity and prices was to be maintained, changing the guideline for money market operations for the intermeeting period to state that it would encourage the uncollateralized overnight call rate to remain at

around 0.25 percent. The Bank also decided to raise the basic loan rate, the loan rate for the complementary lending facility, from 0.1 percent to 0.4 percent.

At the seven MPMs held during the period from August 10 and 11, 2006 to January 17 and 18, 2007, the Bank decided to maintain its guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at around 0.25 percent.

At the MPM on February 20 and 21, 2007, the Bank assessed the outlook for Japan's economy based on incoming data and information, both on domestic and overseas economies, and judged as follows: with the prospects of the economic and price situation improving, the stimulative effect of monetary policy, if the policy interest rate were kept unchanged, could gradually increase; and if expectation takes hold, in such a situation, that interest rates will remain low for a long time regardless of economic activity and prices,

there is a possibility that sustained economic growth will be hampered by misallocation of funds and resources through excess financial and economic activities. The Bank therefore decided to change its guideline for money market operations for the intermeeting period to state that it would encourage the uncollateralized overnight call rate to remain at around 0.5 percent. The Bank also decided to raise the basic loan rate, the loan rate for the complementary lending facility, from 0.4 percent to 0.75 percent.

At the MPM on March 19 and 20, 2007, the Bank decided to maintain its February guideline for money market operations unchanged.

The above policy changes were announced in the public statements, released on July 14, 2006 and February 21, 2007, respectively. These statements follow (attachments 1 and 2).

Change in the Guideline for Money Market Operations

Attachment 1

1. At the Monetary Policy Meeting held today, the Bank of Japan decided, by a unanimous vote, to change the guideline for money market operations for the intermeeting period, effective immediately from the announcement of the decision.

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.25 percent.

2. With respect to the complementary lending facility, the Bank decided, by a 6–3 majority vote, to change the basic loan rate^[Note] applicable under the facility to 0.4 percent, effective immediately from the announcement of the decision, and maintain the temporary waiver of add-on rates for frequent users of the facility. With respect to the outright purchases of long-term interest-bearing Japanese government bonds, purchases will continue at the current amounts and frequency for some time, with due regard for future conditions of the balance sheet of the Bank.
3. Japan's economy continues to expand moderately, with domestic and external demand and also the corporate and household sectors well in balance. The economy is likely to expand for a sustained period. Developments are broadly in line with the projection in the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) released on April 28, 2006. The year-on-year rate of change in consumer prices is projected to continue to follow a positive trend.

^[Note] The basic loan rate is stipulated in Article 15, Paragraph 1, Clause 2 of the Bank of Japan Law. The basic discount rate in Clause 1 in the same paragraph is also set at 0.4 percent (Discounting bills has been suspended).

4. The Bank has maintained zero interest rates for an extended period, and the stimulus from monetary policy has been gradually amplified against the backdrop of steady improvements in economic activity and prices. In this environment, maintaining the previous level of the policy interest rate may result in large swings in economic activity and prices in the future. Taking account of the current assessment of economic activity and prices from the two perspectives outlined in the New Framework for the Conduct of Monetary Policy (March 2006), the Bank judged it appropriate to adjust the level of the policy interest rate at this juncture so that a desirable course of economic activity and prices was to be maintained. Today's policy decision will contribute to ensuring price stability and achieving sustainable growth in the medium to long term.
5. On the future path of monetary policy, the Bank will conduct monetary policy by carefully assessing economic activity and prices. The Bank will adjust the level of the policy interest rate gradually in the light of developments in economic activity and prices if they follow the projection presented in the Outlook Report. In this process, an accommodative monetary environment ensuing from very low interest rates will probably be maintained for some time.

Change in the Guideline for Money Market Operations

Attachment 2

1. At the Monetary Policy Meeting held today, the Bank of Japan decided, by an 8–1 majority vote,^[Note 1] to change the guideline for money market operations for the intermeeting period as stated below (effective immediately).

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.5 percent.

2. With respect to the complementary lending facility, the Bank decided, by an 8–1 majority vote,^[Note 2] to change the basic loan rate^[Note 3] applicable under the facility to 0.75 percent (effective immediately). With respect to the outright purchases of long-term interest-bearing Japanese government bonds, purchases will continue at the current amount and frequency for some time, with due regard for future conditions of the Bank's balance sheet.

^[Note 1] Voting for the action: Mr. T. Fukui, Mr. T. Muto, Ms. M. Suda, Mr. H. Haru, Mr. T. Fukuma, Mr. A. Mizuno, Mr. K. G. Nishimura, and Mr. T. Noda.

Voting against the action: Mr. K. Iwata.

^[Note 2] Voting for the action: Mr. T. Fukui, Mr. T. Muto, Ms. M. Suda, Mr. H. Haru, Mr. T. Fukuma, Mr. A. Mizuno, Mr. K. G. Nishimura, and Mr. T. Noda.

Voting against the action: Mr. K. Iwata.

^[Note 3] The basic loan rate is stipulated in Article 15, Paragraph 1, Clause 2 of the Bank of Japan Law. The basic discount rate in Clause 1 in the same paragraph is also set at 0.75 percent (Discounting bills has been suspended).

3. Reviewing the outlook for Japan's economy based on incoming data and information, both on domestic and overseas economies, the Bank judged that our economy is likely to continue its moderate expansion with a virtuous circle of production, income, and spending in place. Uncertainties over the future course of overseas economies, including that of the United States, are abating, and this is likely to reinforce the prospects of continued increase in corporate profits and business fixed investment. With respect to private consumption, the weakness observed in the last summer seems temporary, and it is judged that private consumption is on a moderate increasing trend.

On the price front, consumer prices (excluding fresh food) have been registering small increases on a year-on-year basis, and it is possible that the rate of change will be around zero in the short run, depending, for example, on developments in the prices of crude oil. From a longer-term perspective, however, consumer prices are likely to increase as a trend, since the utilization of resources such as production capacity and labor has been increasing and the economic expansion is expected to continue.

4. With the prospects of the economic and price situation improving, the stimulative effect of monetary policy, if the policy interest rate were kept at the current level, could gradually increase. If expectation takes hold, in such a situation, that interest rates will remain low for a long time regardless of economic activity and prices, there is a possibility that sustained economic growth will be hampered by misallocation of funds and resources through excess financial and economic activities. The Bank judged that, taking account of the current assessment of economic activity and prices from the two perspectives outlined in the New Framework for the Conduct of Monetary Policy (March 2006), it is appropriate to adjust the level of the policy interest rate at this juncture so that a desirable course of economic activity and prices was to be maintained. Today's policy action will still keep monetary environment very accommodative and the Bank believes that it will contribute to ensuring price stability and achieving sustainable growth in the medium to long term.

5. With regard to the future course of monetary policy, the Bank will adjust the level of interest rates gradually in the light of developments in economic activity and prices, while maintaining the accommodative financial conditions ensuing from very low interest rates for some time.

IV. REVISIONS OF MONETARY POLICY TOOLS

In fiscal 2006, the Bank decided on the following measures related to its monetary policy tools, with a view to improving the procedures for carrying out money market operations.

A. Introduction of Funds-Supplying Operations against Pooled Collateral

At the MPM on April 10 and 11, 2006, the Bank decided to establish Principal Terms and Conditions for Funds-Supplying Operations against Pooled Collateral in order to make transactions related to bill purchasing operations, which were the Bank's main measures to provide funds at the time, paperless. After completing the necessary preparations, the Bank introduced the new operations on June 26, 2006, and abolished its conventional paper-based bill purchasing operations.²

B. Amendment of Margin Tables for Eligible Collateral

At the MPM on October 12 and 13, 2006, the Bank decided to amend the margin tables for eligible collateral. The decision was made as a result of the Bank's annual review of the appropriateness of margins in the light of the latest developments in financial markets, with a view to maintaining the soundness of the Bank's assets and efficiency in market participants' use of collateral.³

C. Amendment of Guidelines on Eligible Collateral to Reflect the Dissolution of the Government Housing Loan Corporation

At the MPM on March 19 and 20, 2007, the Bank decided to amend the Guidelines on Eligible Collateral to reflect the dissolution of the Government Housing Loan Corporation and the establishment of its successor, the Japan Housing Finance Agency, which took place on April 1, 2007.

2. At the MPM on September 7 and 8, 2005, the Bank decided to look into revising the bill purchasing scheme in order to make transactions related to bill purchasing operations paperless, given the broader application of paperless processing to transactions in financial markets.

3. At the MPM on September 7 and 8, 2005, the Bank decided to review the margin tables in light of conditions in financial markets about once a year in principle and to amend them as necessary.

Table 1

Guidelines for Money Market Operations Decided by the Policy Board at Monetary Policy Meetings in Fiscal 2006

Date		Guideline	Votes
2006	Apr. 11	The Bank of Japan will encourage the uncollateralized overnight call rate to remain at effectively 0 percent.	Unanimous vote
	Apr. 28	As above	As above
	May 19	As above	As above
	June 15	As above	As above
	July 14	The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.25 percent.	As above
	Aug. 11	As above	As above
	Sep. 8	As above	As above
	Oct. 13	As above	As above
	Oct. 31	As above	As above
	Nov. 16	As above	As above
2007	Dec. 19	As above	As above
	Jan. 18	As above	Majority vote (three votes against)
	Feb. 21	The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.5 percent.	Majority vote (one vote against)
	Mar. 20	As above	Unanimous vote

Table 2

Opening Sentences of "The Bank's View" in Fiscal 2006

Date		Opening sentence
2006	Apr.	Japan's economy continues to recover steadily.
	May	As above
	June	As above
	July	Japan's economy is expanding moderately.
	Aug.	As above
	Sep.	As above
	Oct.	As above
	Nov.	As above
	Dec.	As above
2007	Jan.	As above
	Feb.	As above
	Mar.	As above