Not to be released until 8:50 a.m. Japan Standard Time on Friday, June 17, 2011.

June 17, 2011

Bank of Japan

Minutes of the Monetary Policy Meeting

on May 19 and 20, 2011

(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 Thursday, May 19, 2011, from 2:00 p.m. to 4:19 p.m., and on Friday, May 20, from 9:00 a.m. to 12:09 p.m.[1]

Policy Board Members Present

Mr. M. Shirakawa, Chairman, Governor of the Bank of Japan

Mr. H. Yamaguchi, Deputy Governor of the Bank of Japan

Mr. K. G. Nishimura, Deputy Governor of the Bank of Japan

Mr. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Government Representatives Present

Mr. M. Sakurai, Senior Vice Minister of Finance, Ministry of Finance[2]

Mr. Y. Kinoshita, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

Mr. K. Umetani, Director-General, Economic and Fiscal Management, Cabinet Office

Reporting Staff

Mr. K. Yamamoto, Executive Director

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Director-General, Monetary Affairs Department

Mr. T. Kato, 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 13 and 14, 2011 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. M. Sakurai was present on May 20.

[3] Mr. Y. Kinoshita was present on May 19.

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

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

Mr. T. Sekine, Head of Economic Research Division, Research and Statistics Department

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

Secretariat of the Monetary Policy Meeting

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

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

Mr. M. Minegishi, Senior Economist, Monetary Affairs Department

Mr. H. Ichiue, 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 28, 2011, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[5] In this situation, the uncollateralized overnight call rate had been in the range of 0.06-0.07 percent.

B. Recent Developments in Financial Markets

Money market rates had been stable amid the Bank's provision of ample funds. General collateral (GC) repo rates had been around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with a one-year maturity, declined slightly, staying in the range of 0.10-0.15 percent. Rates on longer-term interbank instruments had been more or less unchanged.

The benchmark long-term interest rate in Japan had recently been in the range of 1.10-1.15 percent, after declining against the backdrop of a fall in U.S. long-term interest rates as well as somewhat receding concerns about a deterioration in the supply and demand conditions of Japanese government bonds (JGBs). Japanese stock prices had been more or less unchanged overall, mainly because the announced corporate earnings had generally been within the range of market expectations. The Nikkei 225 Stock Average had recently been at around 9,500 yen. In the foreign exchange market, the yen appreciated to some extent against the U.S. dollar, remaining in the range of 81-82 yen to the dollar recently, as U.S. interest rates declined.

C. Overseas Economic and Financial Developments

The world economy continued to recover.

The U.S. economy continued to recover. Exports continued to increase, especially to emerging economies, and business fixed investment rose moderately. Private consumption had been firm mainly due to the effects of the fiscal stimulus measures; nevertheless, balance-sheet adjustments continued to weigh on household spending.

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

5 The guideline was as follows:

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

Housing investment remained at a depressed level, and home prices were weak. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items moved up due to the earlier rise in international commodity prices; on the other hand, the rate of increase in the CPI for all items less energy and food, or the core CPI, remained only moderate as slack in supply and demand conditions in the goods market and the labor market continued to exert downward pressure.

Economic activity in the euro area as a whole continued to recover moderately, with some differences in pace by country. Exports continued to increase, especially to emerging economies, and private consumption and business fixed investment rose gradually. As for prices, although slack in supply and demand conditions and slower growth in wages continued to exert downward pressure, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items rose due to the effects of the earlier depreciation of the euro and rise in international commodity prices. Meanwhile, economic conditions in the United Kingdom were recovering at a moderate pace.

The Chinese economy continued to show high growth. Exports and production continued increasing, and private consumption remained firm due mainly to households' increased income levels. Fixed asset investment maintained high growth. Economic conditions in the NIEs and the ASEAN countries continued to recover, as domestic and external demand stayed on a rising trend. The Indian economy also continued to grow at a relatively rapid pace. In many of these Asian economies, inflationary pressure increased due to higher food and materials prices, reflecting the effects of the increase in international commodity prices, and to greater utilization of production factors such as labor and capital.

As for global financial markets, although favorable corporate results were viewed positively by market participants, U.S. and European stock prices declined slightly compared with the levels at the time of the previous meeting, due to the following factors: some economic indicators that were somewhat weaker than market expectations; concerns about a worsening of sovereign risk problems in some peripheral European countries; and a decline in the stock prices of energy-related firms caused by the fall in crude oil prices. Long-term interest rates in the United States and Europe declined somewhat compared with the levels at the time of the previous meeting, reflecting the view that the recent Federal Open Market Committee (FOMC) meeting showed that the Federal Reserve would continue with its monetary easing, and that expectations about an early additional raising of policy interest rates by the European Central Bank (ECB) had subsided. The yield spreads of government bonds issued by some peripheral European countries over those issued by Germany were hovering around historical highs, as market participants remained concerned about sovereign risk problems.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had decreased substantially since the Great East Japan Earthquake. They were likely to remain at low levels for the time being, but were expected to turn upward as supply-side constraints eased, reflecting the continued improvement in overseas economic conditions.

The rate of decline in public investment was decelerating gradually. Public investment was expected to increase gradually, mainly due to the restoration of damaged social capital.

With regard to domestic private demand, business fixed investment had been relatively weak since the earthquake due to a decline in production and a deterioration of business sentiment. It was expected to increase gradually, aided partly by the restoration of disaster-stricken facilities.

The employment and income situation remained severe, partly due to the effects of the earthquake disaster.

As for private consumption, sagging sales caused by supply-side constraints as well as dampened consumption due to a deterioration of consumer sentiment were observed. Private consumption was expected to pick up partly due to the improvement in household sentiment as production began to recover.

Housing investment was relatively weak due to the disaster. It was expected to increase gradually as supply-side constraints eased and disaster-stricken homes were rebuilt.

Production declined sharply due to supply-side constraints such as supply-chain disruptions. It was expected to remain at a low level for the time being, but was likely to start increasing as the supply-side constraints eased.

As for prices, international commodity prices, which had been rising, had recently fallen back. The three-month rate of change in the domestic corporate goods price index (CGPI) was rising, mainly due to the increase in international commodity prices. The

CGPI was expected to continue rising for the time being, reflecting movements in international commodity prices. The year-on-year rate of decline in the CPI (excluding fresh food) continued to slow, and was around 0 percent. The year-on-year rate of change in the CPI was expected to become slightly positive.

2. Financial environment

Financial conditions generally continued to ease, although weakness had been observed in the financial positions of some firms, mainly small ones, since the earthquake.

The overnight call rate remained at an extremely low level, and the declining trend in firms' funding costs continued. Stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable and, in the corporate bond market, new issuances had recently resumed at a gradual pace after a pause following the earthquake. As for credit demand, firms had recently shown signs of increasing their demand for working capital. Against this backdrop, the year-on-year rate of decline in bank lending was slowing. The amount outstanding of corporate bonds exceeded the previous year's level, and the pace of decline in the amount outstanding of CP was on a decelerating trend. In these circumstances, firms retained their recovered financial positions on the whole, although weakness had been observed in those of some firms, mainly small ones, since the earthquake. Meanwhile, the year-on-year rate of change in the money stock had been in the range of 2.5-3.0 percent.

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

A. Economic Developments

Members discussed the economic and financial conditions abroad, and shared the view that overseas economies continued to recover, led by high growth in emerging and commodity-exporting economies, and would continue to do so.

Members shared the view that the U.S. economy continued to recover. They expressed the view that private consumption had been firm, mainly due to the additional fiscal stimulus measures, an increase in the number of employees, and the wealth effects stemming from the rise in stock prices. One member said that business fixed investment was rising against the backdrop of high corporate profits. A few members expressed the view that exports were strong, especially to emerging economies. Moreover, a few members said that the continuation of accommodative financial conditions was also underpinning economic activity as a whole. Some members, however, made note of the slowdown in the GDP growth rate in the January-March quarter of 2011, and expressed the view that the rise in gasoline prices had reduced real income, thereby adversely affecting private consumption. Some members expressed the opinion that labor market conditions were improving, but the pace of improvement remained slow. Many members expressed the view that recent developments reconfirmed that balance-sheet adjustments continued to weigh on the U.S. economy, making an upward bounce less likely and creating vulnerability on the downside. These members were of the view that such developments did not call for a major revision to their economic outlook. One member expressed the opinion that the downside risk to the economy was not small, noting that market participants' views on the outlook for the U.S. economy had again leaned toward pessimism recently, due to some weaker-than-expected economic indicators.

Members shared the view that economic activity in the euro area as a whole was recovering moderately, but that there were large disparities between core countries, such as Germany, where the economy was strong led by exports, and some peripheral countries, which faced sovereign risk problems. One member noted that Greece faced a vicious circle in which the economic downturn resulting from fiscal austerity eventually led to a fall in tax revenues and an associated fiscal deterioration, undermining market confidence and causing interest rates to rise. Some members made an assessment that market participants thus far remained relatively calm about developments in countries other than Greece, Ireland, and Portugal. Some other members, however, expressed the view that, since speculation about possible debt restructuring in Greece had again heightened market participants' concerns about sovereign risk problems, it was necessary to pay close attention to whether this would lead to instability in global financial markets as a whole. A few members were particularly concerned about the difficulty in solving the sovereign risk problems within a short period of time. A few members pointed out that the ECB was proceeding with the adjustment of its accommodative monetary policy stance against the backdrop of rising inflation in the euro area. One member commented that the economic disparities within the euro area, partly reflecting the sovereign risk problems, could be creating difficulty in terms of the conduct of a single monetary policy for the euro area.

Members agreed that the Chinese economy continued to show high growth. A few members said that domestic demand, such as fixed asset investment and retail sales, was firm and exports exhibited high growth. Most members said that monetary tightening continued in China, as seen in the further raising of the reserve requirement ratio in May. A few members pointed to the possibility that the effects of monetary tightening to date might lead to some deceleration in the Chinese economy in the immediate future. Many members, however, expressed concern that monetary policy responses in China might be somewhat behind the curve amid continued high inflationary pressure, due to overheating of the economy. Many members noted that the rate of increase in consumer prices was quite high amid the continued high growth of the economy. One of these members said that the range of items in the CPI for which prices had risen was spreading from food to services such as housing costs, and attributed this to the rising trend in wages. Meanwhile, a few members pointed to the risk that China could face electricity shortages this summer that might restrain its economic activity. These members said that the central government's direct control in electricity charges to restrain inflationary pressure might have squeezed the profits of electric power companies, preventing them from implementing sufficient fixed investment and adequately maintaining their facilities. As for the outlook, one member said that inflationary pressure might increase further. A few members expressed the view that attention should be paid to the possibility that, even if lagged responses in monetary policy accelerated growth in the short run, this could lead to increased fluctuations in economic activity in the longer run and might undermine sustainable growth. A few members recognized that economic conditions in the NIEs and the ASEAN countries continued to recover with strong domestic and external demand, while inflationary pressure remained high.

Some members commented on <u>the effects of the disaster that hit Japan on overseas economies</u>. They said that, in countries where Japanese firms represented a large proportion of the manufacturing sector, the decreases in imports of parts from Japan appeared to be depressing production in some areas, and that these developments continued to warrant careful monitoring.

Members discussed developments in <u>international commodity prices</u>. They shared the view that these prices had recently been in an adjustment phase, reflecting in part more cautious views on the outlook for the U.S. economy and the consequent changes in investors' risk tolerance. A few members said that such adjustments in commodity prices might be due in part to the unwinding of investment positions among market participants induced by the rise in margin requirements in futures trading in some commodity markets. As for the outlook for international commodity prices, however, many members expressed the view that the adjustments would be temporary and the gradual rising trend would remain intact, as the world economy, particularly emerging economies, continued to show relatively high growth. A few members said that, if the adjustments to the commodity prices continued, a resultant decrease in inflationary pressure could contribute to the sustainable growth of the world economy.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. Regarding the current state of the economy, they agreed that it faced strong downward pressure, mainly on the production side, due to the effects of the disaster. As for the outlook, members shared the view that the economy was likely to continue facing strong downward pressure for the time being, mainly on the production side; thereafter, production was likely to regain traction with easing of supply-side constraints. These members continued that, from the second half of fiscal 2011, the economy was likely to return to a moderate recovery path, backed by an increase in exports reflecting the improvement in overseas economic conditions and by a rise in demand for restoring capital stock. They expressed the recognition that the aforementioned outlook was in line with the Bank's baseline scenario presented in the April 2011 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report).

Regarding recent developments in economic activity, members shared the view that economic indicators released after the previous meeting confirmed that the plunge immediately after the earthquake had been substantial. On this point, many members -- noting the significant decline in the real GDP growth rate for the January-March quarter, of 3.7 percent on an annualized basis -- said that this was attributable to a sharp drop in production caused by the supply-side constraints immediately after the earthquake that resulted in a large decrease in exports and a reduction in inventories. Many members noted a considerable decline in private consumption in March. Many members expressed the view that some survey data collected after the earthquake confirmed a significant deterioration in business and household sentiment, and that this, in addition to the supply-side constraints, depressed domestic private demand.

Members nevertheless agreed that, based on sources such as recently released economic indicators and information obtained from business contacts, there were signs that the economy was improving gradually from the substantial downturn observed immediately after the earthquake, although economic activity remained at a low level. Some members commented that, judging from developments in the production forecast index as well as information obtained from business contacts, the level of production was likely to edge up gradually. With regard to machinery orders, a leading indicator of machinery investment, some members pointed to an increase in actual machinery orders in March and improvement in firms' forecasts for the April-June quarter. On this point, one member added that the improvement in machinery orders should be assessed with some caution, as this indicator tended to fluctuate widely and there might have been some speculative orders against the backdrop of increased uncertainty following the disaster. Moreover, with regard to recent developments in private consumption, many members expressed the view that sales, particularly at department stores and in the food service industry, seemed to be recovering to some extent since early April from the sharp drop immediately following the earthquake. A few members, however, said that the level of consumption was still low compared with that before the earthquake. One member expressed the opinion that the pace of recovery in service-related consumption categories such as travel remained highly uncertain. Meanwhile, as for developments in household sentiment, many members commented that the results of the *Economy Watchers Survey* conducted at the end of April showed that current economic conditions, as perceived by respondents, had stopped worsening and expectations for future economic conditions had improved. A few members pointed out that some indicators showed that business sentiment also had recently stopped deteriorating. Some members expressed the view that, when monitoring changes in sentiment, it was important to focus not only on a short-term deterioration but also on medium- to long-term prospects such as the outlook for and uncertainty regarding economic growth and income.

Members discussed <u>the timing of resolution of supply-side constraints</u> such as supply-chain disruptions and electricity shortages. They expressed the view that, although the supply-chain disruptions were still constraining production, these had started to ease gradually. Many members pointed out that some firms were planning to restore production lines and normalize the supply system of parts at a faster pace than previously anticipated, although such advancement should be assessed with some caution because firms might have drawn up their original schedules in an extremely conservative manner. Moreover, with regard to electric power supply in the summer, when demand would peak, many members raised the possibility that the resultant degree of constraints on economic activity could be less than previously expected, given electric power companies' strengthening of supply capacity and a range of efforts made by firms to cope with anticipated electricity shortages. Based on the above considerations, a few members expressed the view that uncertainty surrounding the resolution of supply-side constraints had decreased recently.

Members shared the view that risks to the outlook for Japan's economy were broadly unchanged from those presented in the April 2011 Outlook Report, and that attention should be paid for the time being to the downside risks to economic activity, especially the possible effects of the disaster. Some members expressed the view that there were still downside risks to sentiment, taking into account such factors as uncertainty regarding the resolution of issues related to the accident at the nuclear power plant in Fukushima Prefecture. One member said that, although the economy had started to move toward recovery from the plunge immediately following the earthquake, the salient point was whether such recovery momentum would remain intact in and after the latter half of fiscal 2011. This member continued that potential downward pressure on economic conditions including the employment and income situation was large, and there was still a high likelihood that the economy would follow a moderate recovery path that deviated downward, in terms of the level of economic activity, from the path projected prior to the earthquake. A few members pointed to the risk that, in the longer run, due to the effects of the disaster, the share of Japanese products in global markets might decline, and/or that the shift of Japanese firms' production sites to overseas as well as changes in the procurement of materials and parts from Japan to other countries might accelerate. Some members expressed the view that, from a relatively long-term perspective, uncertainty about the stability in electric power supply might in fact be increasing, considering the issues regarding the resumption of operations at nuclear power plants following regular inspections.

Members agreed that the year-on-year rate of decline in the CPI (excluding fresh food) continued to slow, and was around 0 percent. They shared the view that the year-on-year rate of change was expected to become slightly positive. As background to this outlook, a few members said that the aggregate supply and demand balance would improve as a trend and the effects of the earlier rise in international commodity prices would have an impact with a lag. In relation to this, one member said that, if the current adjustments in the commodity prices continued, the year-on-year rate of increase in the CPI might accordingly be reduced. With regard to the effects of the disaster on prices, one member commented that downward pressure on economic activity might have a downward impact on prices. A different member expressed the opinion that, as long as the effects of the disaster were temporary and medium- to long-term inflation expectations remained stable, the disaster might not have a substantial impact on the rate of inflation in the economy as a whole. Members concurred that the assessment of risks to the outlook for prices was unchanged from that presented in the April 2011 Outlook Report. They shared the view that, although the year-on-year rate of change in the CPI was likely to become slightly positive, it was likely to be revised downward with the change in the base year for the CPI, scheduled to take place in August 2011.

B. Financial Developments

Members agreed that financial conditions generally continued to ease, although weakness had been observed in the financial positions of some firms, mainly small ones.

Members shared the view that money market rates had been stable amid the Bank's provision of ample funds. Some members said that long-term interest rates in Japan had declined against the backdrop of a fall in U.S. long-term interest rates as well as somewhat receding concerns about a deterioration in the supply and demand conditions of JGBs. As for corporate financing, many members commented that issuing conditions for CP were favorable and issuance rates had returned to levels seen just before the earthquake. Regarding the corporate bond market, members noted that new issuances of corporate bonds had recently resumed at a gradual pace, despite the pause in issuance of electric company bonds that had previously functioned as the benchmark in the market. With regard to issuance rates on corporate bonds, a few members pointed to robust demand among investors, and they had observed a limited increase in recent corporate bond yield spreads over JGBs compared with those just before the earthquake. A few members expressed the view that firms continued to see financial institutions' lending attitudes as being on an improving trend. As for credit demand, one member noted that an increase in precautionary demand for on-hand liquidity was still being observed among firms. Some members pointed out that firms were increasing their demand for working capital. With regard to overall developments in financial markets, one member noted that it was of considerable significance that stability in the financial system was being maintained despite the extremely large decline in economic activity following the earthquake. Most members said that close attention should continue to be paid to the weakness observed in the financial positions of some firms, mainly small ones, since the earthquake.

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

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent. A few members said that it was important for the Bank, based on this guideline, to continue providing ample funds in response to changes in the market situation. A few members were of the view that, in order to ensure market stability, it also remained important for the Bank to secure the markets' understanding of and confidence in the policy time horizon.

As for the future conduct of monetary policy, members concurred that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, it was necessary that the Bank continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. They confirmed that the Bank would continue to carefully examine the outlook for economic activity and prices, including the effects of the disaster, and take appropriate policy actions as necessary.

With regard to the operation of the Asset Purchase Program (hereafter the Program), one member said that the proposal put forward at the previous meeting to increase the amount of the Program was based on the judgment that the timing was appropriate to do so because there was a heightened risk that business and consumer sentiment would deteriorate further as a result of increased anxiety about the future against the backdrop of developments related to the accident at the nuclear power plant. This member expressed the opinion that the need for additional monetary easing was potentially strong, but there was no particular advantage to increasing the amount of the Program at this stage, noting that -- judging from indicators related to the outlook for economic activity and information obtained from business contacts -- a further deterioration in sentiment, which had previously been feared, did not appear to have materialized. A different member said that, although there remained a need for additional monetary easing in view of the current outlook for economic activity and prices, it was important to consider the appropriate timing to implement additional measures by continuing to examine the transmission mechanisms and side effects of each monetary easing measure already taken. Most members expressed the view that it would be appropriate to continue steadily conducting purchases of various financial assets under the framework for additional monetary easing decided immediately after the earthquake, and monitor how the effects of the easing were spreading.

Members then discussed <u>the fund-provisioning measure to support strengthening the foundations for economic growth</u>. Many members expressed the view that, when the results of the Bank's fourth new loan disbursement became available, it would be necessary to carry out a comprehensive assessment of the effects of the provision of funds made so far under the scheme and deliberate on the future conduct of the measure, taking account of comments received from financial institutions.

Some members referred to <u>the funds-supplying operation to support financial institutions in disaster areas</u> and <u>the relaxation of the collateral eligibility standards</u>, and said that they anticipated that these measures would lead to the support of financial institutions in disaster areas. A few members took the view that, although the amount of the first loan disbursement was not particularly large relative to the total amount of loans extendable through the operation, the amount of bids was expected to increase as preparations by financial institutions, including financial cooperatives, advanced and steps toward restoration and rebuilding progressed.

Members shared the view that the objective of the aforementioned operation was to support financial institutions in their initial efforts to meet the demand for restoration and rebuilding and, as for the future course of action, the Bank should continue to examine what kind of policy responses would be necessary while determining when demand for funds for restoration and rebuilding would become full-fledged. On this point, one member expressed the view that it was important for the Bank to continue supporting restoration and rebuilding from the financial side in a seamless manner. A different member commented that it was important to sufficiently gather information regarding the needs at firms and financial institutions in the disaster areas by utilizing the Bank's branches and local offices in these areas. Many members expressed the opinion that, in the course of restoration and rebuilding, it was also necessary to address the fundamental issue facing Japan's economy -- namely, raising its growth potential. Some members expressed the view that demand for funds for restoration and rebuilding was likely to materialize to a considerable extent, and the Bank's role was deemed important from the standpoint of functioning as a catalyst whereby such demand for funds would also lead to a rise in the growth potential. In this regard, one member commented that the Bank could examine whether there was room to utilize the framework for the fund-provisioning measure to support strengthening the foundations for economic growth, making necessary modifications to the framework reflecting a range of characteristics unique to demand for funds for rebuilding. A few other members expressed the view that, since there was great uncertainty at this point regarding the timing of when demand for funds for rebuilding would become full-fledged, it was necessary to examine a range of options, including establishment of a different framework, taking into due consideration responses made by the government and financial institutions.

IV. Remarks by Government Representatives

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

(1) The Japanese economy was showing weakness due to the effects of the disaster, and this was expected to continue for a while. Uncertainty was extremely high, including that over the possibility of a further deterioration in sentiment reflecting the effects of the problem at the nuclear power plant.

(2) The Diet approved the first supplementary budget for fiscal 2011 on May 2. The government would make its utmost efforts to support the living conditions of disaster victims -- for example, by constructing temporary housing and securing employment -- and remove debris and restore infrastructure. Based on ongoing discussions regarding

the roadmap for and principles behind reconstruction, the government would consider formulating additional supplementary budgets. In the first supplementary budget, it allocated the budget for establishing a new guarantee program and a low-interest loan program to support funding for small firms. The government aimed to secure smooth financial functions, particularly in the disaster areas, working in concert with the Bank.

(3) As stated in the basic policies for economic and fiscal management presented in the "Guideline on Policy Promotion," which was decided by the Cabinet on May 17, the government would overcome the restrictions brought about by the disaster in a sequential and steady manner, as well as strengthen the initiatives for achieving new growth and restore the growth potential of the Japanese economy. At the same time, it would steadily proceed with ensuring the sustainability of public finance and social security, as well as maintaining confidence in such institutions.

(4) The government would proceed with discussions on the integrated reform of the social security and tax systems, with a view to finalizing the draft by the end of June in accordance with the Cabinet decision made at the end of 2010. It would revise the "Medium-Term Fiscal Framework" around the middle of 2011, in line with the schedule set in the "Fiscal Management Strategy" decided by the Cabinet in 2010, thereby steadily pursuing fiscal consolidation in an integrated manner with economic growth and the reform of the social security system.

(5) The Bank indicated that it would take appropriate policy actions as necessary. The government expected the Bank to continue taking decisive monetary policy actions while considering the effects of the disaster on the economy and financial markets, as well as the progress of rebuilding.

The representative from the Cabinet Office made the following remarks.

(1) The real GDP growth rate for the January-March quarter registered a decrease of 3.7 percent on an annualized basis. After showing weakness for a while, the Japanese economy was expected to pick up as production recovered. However, due attention needed to be paid to the downside risks to the economy stemming mainly from constraints on electric power supply and the problem at the nuclear power plant.

(2) The economy was still in a mild deflationary situation with continued downward pressure on prices, due to the decline in demand, while there were supply-side

constraints caused by the effects of the disaster. Amid concerns that weakness in the economy might continue for the time being, due to the effects of the disaster, close attention should be paid to the effects on economic activity of the upward pressure on costs exerted by the supply-side constraints and sharp rise in energy prices.

(3) On May 17, the "Guideline on Policy Promotion," including the basic policies for economic and fiscal management after the earthquake, was decided by the Cabinet. Based on the guideline, with a view to achieving a prompt recovery from the disaster, the government would swiftly implement the first supplementary budget and strengthen the initiatives to restore the growth potential of the Japanese economy, which was facing supply-side constraints. At the same time, it was important to maintain confidence in public finance, and the government would finalize the draft of the integrated reform of the social security and tax systems by the end of June.

(4) The government expected the Bank to steadily carry out the funds-supplying operation to support financial institutions in disaster areas, in order to support restoration and rebuilding of the disaster areas from the financial side. The government also hoped that the Bank would share with it the basic perspectives with regard to the macroeconomic management indicated within the "Guideline on Policy Promotion," and continue to underpin the economy through appropriate and flexible conduct of monetary policy while continuing to sufficiently exchange views and keep close contact with the government.

V. Votes

Based on the above discussions, members shared the view that it was appropriate to maintain the current guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

To reflect this view, the chairman formulated the following proposal and put it to a vote.

The Chairman's Policy Proposal on the Guideline for Money Market Operations:

1. The guideline for money market operations for the intermeeting period ahead will be as follows.

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

2. A public statement will be decided separately.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, and Ms. S. Shirai.
Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

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

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of April 28, 2011 for release on May 25, 2011.

Attachment

May 20, 2011

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,[6] to set the following guideline for money market operations for the intermeeting period:

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

2. Japan's economy faces strong downward pressure, mainly on the production side, due to the effects of the earthquake disaster. Production has declined sharply due to the supply-side constraints caused by the disaster. As a result, exports have decreased substantially, and domestic private demand has also been weak partly affected by a deterioration in business and household sentiment. Meanwhile, financial conditions have generally continued to ease, although weakness has been observed in the financial positions of some firms, mainly small ones, since the earthquake. The year-on-year rate of decline in the CPI (excluding fresh food) has continued to slow, and has been around 0 percent.

3. According to the Bank's baseline scenario, Japan's economy is likely to continue facing strong downward pressure, mainly on the production side, for the time being; however, backed by an increase in exports reflecting the improvement in overseas economic

[6] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, and Ms. S. Shirai.
Voting against the action: None.

conditions and by a rise in demand for restoring capital stock, the economy is expected to return to a moderate recovery path from the second half of fiscal 2011 as supply-side constraints ease and production regains traction. The year-on-year rate of change in the CPI is expected to become slightly positive.[7] Based on these assessments, Japan's economy is expected to return to a sustainable growth path with price stability in the longer run.

4. In the area of economic activity, there is a high degree of uncertainty about the effects of the earthquake disaster on Japan's economy. With regard to overseas economies, on the one hand, growth in emerging and commodity-exporting economies could turn out to be stronger than expected due to robust domestic demand and capital inflows from abroad; on the other hand, the effects of balance-sheet adjustments on the U.S. economy and the possible consequences of the sovereign risk problems in Europe continue to warrant attention. Meanwhile, turning to the implications of the rise in international commodity prices, on the one hand, the high growth in emerging and commodity-exporting economies that lies behind the price rise is likely to provide a boost to Japan's exports; on the other hand, the decline in real purchasing power resulting from the deterioration in the terms of trade could reduce domestic private demand in Japan. In particular, for the time being, attention should be paid to the downside risks to economic activity, especially the possible effects of the disaster. Regarding the outlook for prices, there is a possibility that inflation will rise more than expected if international commodity prices increase further, while there is also a risk that the rate of inflation will deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations.

5. In order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank will continue to consistently make contributions as the central bank through the three-pronged approach of pursuing powerful monetary easing consisting of comprehensive monetary easing, ensuring financial market stability, and providing support to strengthen the foundations for economic growth.

[7] The year-on-year rate of change in the CPI is likely to be revised downward with the base-year change scheduled for August 2011.

The Bank will continue to carefully examine the outlook for economic activity and prices, including the effects of the disaster, and take appropriate policy actions as necessary.