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August 14, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on July 11 and 12, 2012

(English translation prepared by the Bank's staff based on the Japanese original)

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Wednesday, July 11, 2012, from 2:00 p.m. to 4:29 p.m., and on Thursday, July 12, from 9:00 a.m. to 12:46 p.m.[1]

Policy Board Members Present

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

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

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

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance[2]

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

Mr. H. Ogushi, Parliamentary Secretary of Cabinet Office, Cabinet Office[2]

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

Reporting Staff

Mr. H. Nakaso, Executive Director (Assistant Governor)

Mr. H. Hayakawa, Executive Director

Mr. N. Kinoshita, Executive Director

Mr. K. Momma, Executive Director

Mr. S. Uchida, Director-General, 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 8 and 9, 2012 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. Y. Fujita and H. Ogushi were present on July 12.

[3] Messrs. S. Sato and K. Matsuyama were present on July 11.

Mr. T. Umemori, Deputy Director-General, Monetary Affairs Department[4]

Mr. K. Kamiyama, Head of Policy Planning Division, Monetary Affairs Department

Mr. S. Aoki, Director-General, Financial Markets Department

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

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

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

Secretariat of the Monetary Policy Meeting

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

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

Mr. H. Kanno, Head of Policy Infrastructure Division, Monetary Affairs Department[4]

Mr. H. Kamiguchi, Senior Economist, Monetary Affairs Department

Mr. T. Kawamoto, Senior Economist, Monetary Affairs Department

[4] Messrs. T. Umemori and H. Kanno were present on July 12.

I. Summary of Staff Reports on Economic and Financial Developments[5]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on June 14 and 15, 2012, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[6] In this situation, the uncollateralized overnight call rate had been in the range of 0.075 to 0.085 percent.

In the money market, the sense of an abundance of liquidity continued to be strong amid the Bank's provision of ample funds. In this situation, with the aim of operating the Asset Purchase Program (hereafter the Program) smoothly, the Bank continued to work on increasing market participants' incentive to bid in the Bank's fixed-rate funds-supplying operation against pooled collateral (hereafter the fixed-rate operation) by, for example, setting the date of repayment flexibly. However, undersubscription had occurred in the fixed-rate operation with a six-month term on a continuous basis, as well as in outright purchases of Japanese government bonds (JGBs) with a remaining maturity of up to one year.

B. Recent Developments in Financial Markets

Money market rates, including longer-term ones, had been stable at low levels. General collateral (GC) repo rates had been at around 0.1 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with longer maturities, had been stable at around 0.1 percent. Issuance rates on T-Bills, meanwhile, had been marginally below 0.1 percent in many cases. Rates on longer-term interbank instruments had been more or less unchanged.

The Nikkei 225 Stock Average recovered to the 9,000 yen level at one point, mainly because risk aversion among investors had abated somewhat, reflecting their positive response to the outcome of the Greek election in mid-June 2012 and the agreement made at the European Council meeting in end-June. It then fell back, and had recently been moving in the range of 8,500-9,000 yen. Prices for Japan real estate investment

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

[6] 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.

trusts (J-REITs), in line with movements in stock prices, had risen temporarily and declined somewhat thereafter. The benchmark long-term interest rate remained at a low level, and had recently been moving slightly below the 0.8 percent level amid active buying of bonds by some investors that had surplus funds following a massive redemption of JGBs. Yield spreads between corporate bonds and JGBs continued to be more or less unchanged on the whole, reflecting solid demand from investors for corporate bonds. The yen depreciated against both the U.S. dollar and the euro as risk aversion among investors abated somewhat. It then appreciated to some extent, particularly against the euro, due to the policy interest rate cut by the European Central Bank (ECB) and heightened uncertainty regarding the European debt problem. The yen had recently been in the ranges of 79-80 yen against the dollar and 97-98 yen against the euro.

C. Overseas Economic and Financial Developments

Overseas economies had shown some, albeit moderate, improvement, but on the whole still had not emerged from a deceleration phase.

The U.S. economy generally continued to recover at a moderate pace, although signs of weakness were observed, such as in business sentiment. Private consumption was increasing, reflecting a modest improving trend in the employment situation, but the pace of recovery was generally moderate partly because the balance-sheet repair continued to weigh on the economy. Housing investment remained at a depressed level with weakness in housing prices, although home sales showed some signs of a pick-up. In the corporate sector, the momentum of growth in exports slowed, and some indicators for business sentiment declined. Nevertheless, business fixed investment maintained its uptrend and production also continued to increase moderately. As for prices, while slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, the year-on-year rate of increase in the consumer price index (CPI) for all items decelerated due to a gradual decline in energy prices, such as those of gasoline.

Economic activity in the euro area had been sluggish. Exports continued to show signs of a pick-up. On the other hand, business fixed investment had been declining and private consumption was more or less unchanged as household and business sentiment was weakening, particularly in peripheral countries. Under these circumstances, production was declining. As for prices, in a situation where slack in supply and demand conditions was exerting downward pressure on prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items decelerated somewhat, reflecting the decline in gasoline prices in particular. Meanwhile, economic activity in the United Kingdom had been sluggish as well.

With regard to Asia, although the Chinese economy continued to show relatively high growth, the pace was slowing. Signs of a pick-up in exports were seen mainly in those to the United States. In terms of domestic demand, the rates of increase in fixed asset investment and private consumption had decelerated, although they remained at relatively high levels. These slowdowns resulted from the deceleration in private real estate investment for the former and in the consumption of durable goods such as electrical appliances for the latter. Given such developments, the rate of increase in production was decelerating. Regarding the NIEs and the ASEAN countries, the pace of economic growth had begun to pick up. As for domestic demand, business fixed investment had been increasing moderately and private consumption had been firm. The momentum of growth in exports and production had slowed, mainly due to sluggish growth in exports to Europe and China. As for prices, in many of the NIEs and the ASEAN countries, core inflation rates had been at relatively high levels, mainly reflecting the wage inflation caused by tight labor market conditions. On the other hand, inflation rates for all items had declined at a moderate pace, due mainly to a halt in the surge in food prices. In India, the deceleration of economic growth had come to a halt.

In global financial markets, some nervousness continued to be seen, mainly reflecting concern over the European debt problem. In June 2012, risk aversion among investors abated somewhat, reflecting their positive response to the outcome of the Greek election in the middle of the month and the agreement made at the European Council meeting at the end of the month. Since the start of July, however, the markets had seen renewed uncertainty. With regard to the yield spreads of government bonds issued by European countries over German government bonds, those for Greece declined substantially after the election, while those for Spain, Italy, and Ireland narrowed temporarily following the European Council meeting but widened thereafter. U.S. and European stock prices showed somewhat large fluctuations: they rose in reflection of receding concern over the European debt problem but then started to fall again. Long-term interest rates in Germany had been declining as the ECB cut policy interest rates. Those in the United States, after having been more or less unchanged, declined to some extent following the release of economic indicators that turned out to be weaker than market expectations. With regard to corporate bond markets in the United States and Europe, credit spreads on corporate bonds had been flat. Stock prices and currencies in emerging and commodity-exporting economies had been more or less unchanged on the whole. The funding conditions of European financial institutions continued to be stable on the whole. Spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates had been more or less unchanged. The U.S. dollar funding premium in the foreign exchange swap markets rose somewhat while spreads between interest rates on U.S. dollar-denominated term instruments and OIS rates were generally unchanged.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had shown signs of a pick-up. They were expected to increase moderately as overseas economies emerged from the deceleration phase.

Public investment continued to increase, primarily in that related to reconstruction following the earthquake disaster. The amount of public construction completed -- a measure that reflected the progress of public works -- was almost flat in April 2012 relative to the January-March quarter, after having registered a quarter-on-quarter increase in that quarter. The value of public works contracted -- a measure that reflected public works orders -- had risen in the January-March quarter on a quarter-on-quarter basis, and also registered a significant increase in the April-May period relative to that quarter. Against this background, public investment was expected to be on the rise.

Business fixed investment had been on a moderate increasing trend with improvement in corporate profits. It was expected to continue on this uptrend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities as well as to strengthen earthquake resistance and business continuity systems, as corporate profits kept improving. Business fixed investment plans for fiscal 2012 (excluding software investment and including land purchasing expenses; all-size enterprise and all-industry basis) in the June 2012 *Tankan* (Short-Term Economic Survey of Enterprises in Japan) were revised upward from those in the March *Tankan*, and registered a year-on-year increase of 4.0 percent.

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

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

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

Production had started picking up moderately with some fluctuations, and was expected to increase moderately as domestic demand remained firm and as exports picked up gradually. Judging from interviews with firms and other relevant information, production was expected to increase at a modest pace through the July-September quarter of 2012, mainly reflecting the rise in domestic demand, particularly in that related to reconstruction, as well as the progress in inventory adjustments of chemicals and IT-related goods.

As for prices, international commodity prices had been more or less flat, after having fallen back through June 2012. The three-month rate of change in the domestic corporate goods price index (CGPI) had turned negative, mainly because international commodity prices had fallen back. The CGPI was expected to continue declining moderately for the time being, mainly reflecting movements in international commodity prices. The year-on-year rate of change in the corporate services price index (CSPI) for all items excluding international transportation, having seen a deceleration in the pace of decline, had recently been slightly positive. The year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and was expected to stay at this level for the time being.

2. Financial environment

Financial conditions continued to ease.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. As for credit demand, firms showed signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of change in the amount outstanding of bank lending had been positive. That of CP had also been positive. In contrast, the year-on-year rate of change in the amount outstanding of corporate bonds had been negative as the amount of electric company bonds redeemed continued to exceed the amount issued. In these circumstances, firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock had been positive at around 2 percent.

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

A. Economic Developments

In terms of global financial markets, members agreed that some nervousness continued to be seen, mainly due to concern about the European debt problem, and therefore particular attention should be paid to developments in these markets for the time being. They shared the view that, although certain progress had been made at the European Council meeting in end-June 2012, there was no marked change in the underlying situation in which market tensions were likely to heighten. They continued that such tensions in the markets stemmed from a high degree of uncertainty over the implementation of fiscal and economic structural reforms as well as financial stability measures encompassing detailed schemes for providing financial assistance to Spain, which was agreed at the council meeting. A few members expressed the view that tensions in the markets regarding the European debt problem had intensified and eased repeatedly, and that this cycle was shortening gradually. Meanwhile, members noted that the situation of interbank funding markets was of importance in terms of ensuring the stability of the financial system, and shared the recognition that the markets remained generally stable, mainly due to the effects of the provision of a large amount of funds by the ECB. They continued that it was less likely that disturbances in global financial markets would trigger a severe global economic downturn, as happened at the time of the Lehman shock -- a scenario that was a matter of significant concern at around the end of 2011. Some members added that, as it was likely to take time to resolve the European debt problem, due attention should nevertheless continue to be paid to the risk that stability of the financial markets would deteriorate suddenly if, for example, actions by each country's government and central bank to address the problem should fall short of market expectations.

With regard to the fact that long-term interest rates, particularly in the United States and Germany, had declined to historically low levels, members shared the view that this reflected an increase in demand for government bonds issued by the United States, Germany, and Japan -- which were regarded as safe assets -- in a situation where concern over the European debt problem had not yet been relieved. A few members pointed out that long-term interest rates in the United States and Germany were at levels below the growth rates of nominal GDP for the respective countries. These members said that, on the one hand, interest rates could eventually rise to levels consistent with the growth rates, but on the other hand, the growth rates could decline to levels consistent with the interest rate levels. On this basis, these members commented that such developments should be monitored closely because they could affect long-term interest rates in Japan.

Members concurred that overseas economies had shown some, albeit moderate, improvement, but on the whole still had not emerged from a deceleration phase. They shared the view that, although the outlook remained highly uncertain, these economies were likely to gradually emerge from this deceleration phase.

As for the U.S. economy, members agreed that it generally continued to recover at a moderate pace and was likely to continue to do so, supported mainly by the accommodative financial conditions. Many members expressed the recognition that, while signs of weakness were observed, such as in business sentiment, and the momentum of growth in employment was slowing, private consumption remained firm on the back of a decline in gasoline prices and home sales showed some signs of a pick-up. Regarding the fact that the growth in nonfarm payroll employment had slowed and the decline in the unemployment rate had paused, some members expressed the view that the employment situation could be judged as maintaining a modest improving trend, once the average of these figures over the past six months or so was taken into account in order to eliminate the seasonal effects, such as those of the warm winter.

As for the euro area, members agreed that, despite signs of a pick-up in exports, economic activity in the area had been sluggish, mainly due to stagnant domestic demand. They also agreed that the economy was likely to remain sluggish for the time being given that fiscal austerity and severe financial conditions were likely to continue, particularly in peripheral countries. A few members pointed out that weak domestic demand in peripheral countries was exerting downward pressure on production and depressing business sentiment in core countries. A few other members said that weakness in the euro area economy was exerting downward pressure not only on countries that were largely dependent on exports to the euro area -- such as China -- but also on Japan and other countries that were indirectly linked with the euro area through exports and imports with the former countries. As for the effects of the European debt problem, these members, noting that uncertainty regarding the outlook for the problem was adversely affecting business sentiment around the world, expressed concern that this might lead to a weakening in firms' fixed investment. A different member added that due attention should continue to be paid to the risk that a worsening of the European debt problem would lead to a decline in stock prices and an appreciation of the yen, which would negatively affect business and household sentiment, for example, thereby exerting downward pressure on Japan's economy.

Members shared the view that, although the Chinese economy continued to show relatively high growth, the pace was slowing and this situation had been somewhat more prolonged than expected. Some members attributed this to the effects of the slowdown in the rate of increase in exports to Europe, in addition to those of the earlier monetary tightening and of measures to restrain the increase in real estate transactions. As for the outlook, members agreed that the Chinese economy was likely to gradually show clear signs of recovery on the back of the implementation of a range of policy measures, although the timing of such recovery was slightly delayed. Regarding the NIEs and the ASEAN countries, some members expressed the view that, although the momentum of growth in exports had slowed, the pace of economic growth had begun to pick up on the whole as private consumption and business fixed investment had been firm, partly due to a recovery in real purchasing power reflecting a decline in crude oil prices in particular, and to policy actions including monetary easing.

Based on this discussion, a few members commented that, as a mechanism through which overseas economies would emerge at some point from the deceleration phase, it was likely that both the U.S. and Chinese economies would become the driving force in the global economy by generating positive effects for each other. One member added that, in assessing the future growth rates of overseas economies, it was necessary to bear in mind the possibility that the potential growth rates of these economies could be declining due to the effects of the financial crisis and the European debt problem.

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

Regarding recent developments in the economy, members agreed that Japan's economic activity had started picking up moderately as domestic demand remained firm mainly supported by reconstruction-related demand. They concurred that public investment continued to increase with the progress in the execution of the budget related to the earthquake disaster, and business fixed investment had been on a moderate increasing trend with improvement in corporate profits. One member pointed out that some indicators were weak, such as machinery orders for May, and thus future developments should be carefully monitored. Members shared the recognition that, against the background of improvement in consumer sentiment, private consumption had continued to increase moderately due to the effects of measures to stimulate demand for automobiles, and that housing investment had generally been picking up. As the background to the firmness in domestic demand, a few members, while referring to the discussions at the previous meeting, cited the following: (1) the effects of policy measures such as subsidies for purchasers of environmentally friendly cars; (2) reconstruction-related demand in a broad sense, such as consumption related to the rebuilding of daily lives in the disaster areas, restoration and reconstruction of disaster-stricken facilities, investment in strengthening earthquake resistance and business continuity systems, and reinforcement of new electric power facilities such as "mega solar" power plants; (3) recovery in business sentiment, which reflected the improvement in corporate profits, and a resultant halt in the decline in wages and income; (4) progress in exploring potential demand, particularly consumption related to the aging population; and (5) an increase in real purchasing power due to the appreciation of the yen. Members shared the view that, reflecting these developments in reconstruction-related demand and firm private consumption, the June 2012 *Tankan* showed that the diffusion index for business conditions had been improving moderately, particularly in domestic demand-oriented sectors. They agreed that exports had shown signs of a pick-up. They shared the recognition that production had started picking up moderately with some fluctuations, reflecting these developments in demand at home and abroad. A few members, noting that production had recently lost its momentum toward recovery, said that, although this basically seemed to be the result of sluggish overseas demand, further developments in relevant data should be monitored closely since the firmness in domestic demand could not necessarily be fully observed by the recent developments in production.

As for the outlook for the economy, members agreed that it was likely to return to a moderate recovery path as domestic demand remained firm and overseas economies emerged from the deceleration phase. They then shared the recognition that the key factor was whether domestic demand would remain firm until a recovery in external demand became evident. On this point, a few members said that some of the factors that underpinned the current firmness in private consumption were likely to dissipate: for example, the budget allocated for subsidies for purchasers of environmentally friendly cars would run out and pent-up demand following the earthquake disaster would wane. On the other hand, these members noted that some other factors, such as the improvement in corporate profits as well as in the employment and income situation, would likely be sustainable to some extent and contribute to the firmness in private consumption. Many members pointed out that firms' business plans for fiscal 2012 in the June 2012 *Tankan* showed that firms were planning to increase fixed investment with improvement in sales and profits. On this basis, these members expressed the view that further improvement in corporate profits was likely to lead to an increase in business fixed investment and to an improvement in the employment and income situation, thereby underpinning private consumption. One member noted that the level of summer bonus payments in 2012 was projected to be somewhat weak, reflecting the lackluster business performance in fiscal 2011, and added that it was necessary to pay attention to whether these developments, as well as the end of various policy measures to stimulate demand, would affect private consumption.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and likely to stay at this level for the time being. Many members expressed the view that prices would be somewhat weak for the time being due to the decline in international commodity prices, but expected that this in turn would support private consumption through an increase in real purchasing power. These members continued that the outlook was therefore unchanged, in that the price situation was likely to be on a moderate improving trend as the negative output gap narrowed steadily.

One member expressed the view that, compared with the situation around 2004, when the supply and demand balance had been similar to the current level, prices were more inclined to rise as the aggregate supply and demand balance improved. This member pointed to the following as reasons behind this view: (1) downward pressure on import prices was easing, reflecting the rise in wages in China; (2) room for further improvement in efficiency was considered to be limited as significant progress had been made in the restructuring of the distribution system; (3) the price-setting behavior of some firms that were focused on securing profits was observed; and (4) some shifts in consumers' preference for high-value-added goods and services were observed, although their preference for inexpensive goods and services persisted.

B. Financial Developments

Members agreed that financial conditions in Japan continued to ease.

Members agreed that the money market had been extremely stable, as the Bank had been pursuing powerful monetary easing and the soundness of financial institutions' balance sheets had been maintained. They shared the view that issuing conditions for CP remained favorable, as did those for corporate bonds on the whole. They were of the view that firms' funding costs had declined moderately, and that the availability of funds remained on an improving trend. A few members noted that the June 2012 *Tankan* showed that indicators representing financial conditions, such as those of financial institutions' lending attitudes as perceived by firms and of the financial positions of firms, had improved to levels clearly exceeding the average for the period since 2000.

C. Interim Assessment

Given the above assessment of recent developments, members concurred that growth prospects would likely remain broadly unchanged from the forecasts presented in the April 2012 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). With regard to growth prospects for fiscal 2012, they shared the view that, although the balance between domestic and overseas demand had changed slightly -- such that overseas demand was likely to be weaker than projected while domestic demand would probably be somewhat stronger than expected -- overall prospects remained broadly unchanged from those in April. Many members attributed the weaker-than-projected overseas demand to the fact that overseas economies on the whole still had not emerged from a deceleration phase, mainly due to the effects of the European debt problem, and said that the timing of their recovery was likely to be slightly delayed. On the other hand, as background to the prospect for domestic demand to be somewhat stronger than expected, many members noted that a rise in reconstruction demand in a broad sense -- in terms of both public and private demand -- would contribute to economic growth. One member said that crude oil prices had declined compared to those in April, which could improve real purchasing power and thereby underpin private consumption. Members shared the view that, in fiscal 2013, as overseas economies would achieve relatively high growth, Japan's economy was likely to keep growing at a pace that was clearly above its potential, although its growth rate would probably be somewhat lower than that in fiscal 2012 because the positive effects from reconstruction demand would gradually diminish.

With regard to prices, members concurred that the year-on-year rate of change in the CGPI would likely be somewhat lower for fiscal 2012 compared with the forecasts presented in the April 2012 Outlook Report, partly due to the effects of the fall in crude oil prices and the rebasing of the index, but broadly in line with the April forecasts for fiscal 2013. They shared the view that the year-on-year rate of change in the CPI (all items less fresh food) was likely to be broadly in line with the April forecasts. With regard to the background to the forecast that developments in the CPI for fiscal 2012 were likely to be in line with the April forecasts, they shared the recognition that there had been no significant change in the fundamental factors regarding prices: (1) growth prospects remained broadly unchanged from those in April; (2) the aggregate supply and demand balance would likely improve at about the same pace as projected in April; and (3) medium- to long-term inflation expectations remained stable. As for the change in the outlook for the CPI (all items less fresh food) for fiscal 2012 from that in April, one member added that the effects of the recent decline in crude oil prices were offset to a large degree by the effects of an increase in electricity charges. On this basis, members reaffirmed their view that, while medium- to long-term inflation expectations remained stable, the year-on-year rate of change in the CPI was likely to gradually rise to a range of above 0.5 percent and less than 1 percent toward the latter half of the projection period -- which covered fiscal 2012 through fiscal 2013 -- as the aggregate supply and demand balance improved. They continued that, thereafter, it would likely be not too long before the rate reached 1 percent.

One member, presenting an outlook for prices of goods, services, and energy, as well as rent -- which comprised the CPI -- based on the historical relationship with wages and with the supply and demand balance, expressed the view that the outlook for the CPI was reasonably convincing, although some latitude would be necessary.

In terms of risk factors for the economic outlook, members shared the recognition that there remained a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. Regarding the European debt problem, they shared the view that instability in global financial markets and a deceleration in overseas economies stemming from the worsening of the problem remained risks of most concern. With regard to uncertainty over the outlook for the U.S. economy, some members said that, in addition to the adverse impact of the European debt problem, it was necessary to carefully monitor the situation surrounding the "fiscal cliff" -- a state in which fiscal spending cuts and tax increases would be implemented simultaneously at the beginning of 2013 -- and its effects on the U.S. economy amid persisting strains from balance-sheet adjustments. Regarding risks to the outlook for emerging and commodity-exporting economies, members shared the view that the risk of the European debt problem spreading to these economies through trade and finance continued to warrant attention. They continued that there remained a high degree of uncertainty about whether these economies -- including China, where policy actions including monetary easing had been taken in response to the economic slowdown, which had been somewhat more prolonged than expected -- could simultaneously achieve price stability and economic growth. As risk factors unique to Japan's economy, one member pointed to (1) uncertainty over how reconstruction-related demand would develop and how the effects of such developments would spread, (2) uncertainty regarding the balance of supply and demand for electric power, and (3) ongoing developments in the government's credibility in financial markets toward achieving fiscal sustainability.

As for risk factors for the outlook for prices, members agreed that careful attention should be paid to future developments in international commodity prices and in medium- to long-term inflation expectations. Some members, noting that households' and firms' short-term inflation expectations were susceptible to developments in actual inflation rates, expressed the view that attention should also be paid to the possibility of heightened expectations that prices were unlikely to rise, what with the year-on-year rate of change in the CPI remaining at a low level for a long time, and this in turn could cause a weakening in actual price developments.

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.

In relation to monetary policy for the immediate future, members shared the view that Japan's economy faced the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. They continued that, based on the recognition that this challenge would be met through efforts by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side, the Bank had been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. They agreed that the Bank would continue to conduct monetary policy in an appropriate manner. In order to achieve the Bank's "price stability goal in the medium to long term," one member noted that an uptick in prices in the absence of economic improvement was not desirable. This member added that, as the economy recovered and the negative output gap narrowed, it was necessary to continue to pay attention to the optimal pace of monetary easing to achieve a rise in prices in balance with the increases in corporate profits and wages. Members reaffirmed the view that it was necessary for the Bank to do its utmost to ensure the stability of Japan's financial system while paying particular attention to developments in global financial markets, where some nervousness persisted, reflecting the European debt problem. A few members said that Japan's economy could be adversely affected through various channels if, for example, a substantial risk materialized, stemming from the European debt problem. These members continued that the Bank should therefore stand ready to take appropriate actions without ruling out any options in advance.

In terms of the Program, members agreed that it was appropriate to proceed with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program, which was expanded as a result of the decision made at the April 27 meeting, and also to monitor its effects. Members then discussed the fact that the steady accumulation of the amount outstanding of the Program had been disrupted by the frequent occurrence of so-called undersubscription -- that is, aggregate bids falling short of the Bank's offers -- in the fixed-rate operation and some other purchases. On this issue, they shared the recognition that the occurrence of undersubscription itself was attributable to a decline in the prevailing interest rates in the short-term money market, which had often been below 0.1 percent, and indicated that the effects of the Bank's powerful monetary easing had been permeating the financial markets. They continued that, nevertheless, it was vital that the Bank -- with a view to clarifying its policy stance to pursue powerful monetary easing -- steadily increase the amount outstanding of the Program even under such circumstances, and that the Bank should therefore deliberate on specific measures to this end. As measures to steadily increase the amount outstanding of the Program, a few members expressed the view that it was appropriate to reduce the maximum amount outstanding of the fixed-rate operation, where undersubscription had occurred on a continuous basis, and instead allocate the reduced amount to outright purchases of T-Bills as similar short-term assets. With regard to outright purchases of T-Bills, some members noted that it was necessary to devise ways to ensure smooth purchases because undersubscription could occur if the Bank increased the amount of purchases. Regarding the size of reduction in the maximum amount outstanding of the fixed-rate operation, one member commented that 5 trillion yen would be a benchmark, taking into account the amount outstanding of loans provided through the operation so far and the recent developments in financial institutions' bids for the operation.

Based on the above discussion, the chairman requested that the staff explain the specifics of the measures to reduce the occurrence of undersubscription and steadily increase the amount outstanding of the Program.

In response to the chairman's direction, the staff provided the following explanation regarding the measures.

(1) First, the staff considered that it would be appropriate for the Bank to reduce the maximum amount outstanding of the fixed-rate operation -- where undersubscription had been occurring frequently -- and instead increase outright purchases of T-Bills as similar short-term assets. The amounts of the reduction and the increase would be

about 5 trillion yen, respectively, taking into account the results of the fixed-rate operation.

(2) Second, in view of the fact that the prevailing market interest rates on T-Bills had often been below 0.1 percent of late, it would be appropriate for the Bank to remove the minimum bidding yield for outright purchases of T-Bills -- which was currently 0.1 percent per annum -- in order to ensure smooth purchases following the proposed increase. In doing so, it would be appropriate to remove the minimum bidding yield for outright purchases of CP, which was another short-term asset.

(3) Third, it would be appropriate for the Bank to integrate loan durations -- which were currently "3 months" or "6 months" -- into "within 6 months" under the fixed-rate operation, in order to respond flexibly to financial institutions' liquidity demand.

In response to the staff's explanation, members resumed discussions. They agreed that it would be appropriate for the Bank to reduce the maximum amount outstanding of the fixed-rate operation by about 5 trillion yen and instead increase outright purchases of T-Bills as similar short-term assets, by the same amount.

Members also shared the recognition that it would be appropriate to remove the minimum bidding yield for outright purchases of T-Bills in order to ensure smooth purchases. They continued that it would also be appropriate to remove the minimum bidding yield for outright purchases of CP, which was another short-term asset. Regarding the potential effects of these measures on short-term market rates, members shared the view that the market rates were unlikely to decline significantly given that interest rates applied to the fixed-rate operation and the complementary deposit facility would be maintained at 0.1 percent and arbitrage between these rates and the market rates would work. Meanwhile, one member noted that there had been some market speculation about a possible reduction in the interest rate applied to the complementary deposit facility, and that the occurrence of undersubscription was partly attributable to this speculation. This member continued that the Bank should therefore communicate to the public in an effective manner so that the measures to remove the minimum bidding yield would not raise market expectations that the Bank would reduce that interest rate. On this basis, members discussed the relationship between the set of measures proposed at this meeting and the interest rate applied to the complementary deposit facility. They reaffirmed that the effects of monetary easing would be maximized under the current combination of paying

0.1 percent interest on excess reserve balances and the guideline for money market operations that the Bank would encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

With regard to the fixed-rate operation, members, noting that it was appropriate for the Bank to apply loan durations of "3 months" or "6 months" flexibly depending on the market conditions at the time, concurred that it was appropriate to indicate loan durations with a degree of latitude -- that is, "within 6 months" -- so as to be prepared for circumstances that would require the Bank to respond more flexibly to financial institutions' liquidity demand. Some members commented that the set of measures proposed at this meeting would contribute to increasing the amount outstanding of the Program more steadily, and that the Bank would be able to achieve accumulation of the amount outstanding of the Program as scheduled -- namely, increase the amount outstanding of the Program to about 65 trillion yen by around end-2012 and about 70 trillion yen by around end-June 2013.

IV. Remarks by Government Representatives

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

(1) The government was currently making its best efforts to work on the comprehensive reform of the social security and taxation systems. It would also continue to do its utmost to promptly obtain the Diet's approval of bills related to the comprehensive reform.

(2) The Japanese economy was on the way to recovery at a moderate pace, partly supported by reconstruction demand. As for the outlook, movement toward sound recovery was expected to take hold. However, against the background of continued high concern over the European debt problem, there were downside risks to the Japanese economy stemming from sharp fluctuations in the financial markets, including a further appreciation of the yen, and from further slowdowns in overseas economies. The government regarded the European debt problem as a risk that warranted the most attention. It expected the Bank to continue to carefully monitor how the European debt problem would affect the Japanese economy and to make every effort to avoid a slowdown. Furthermore, the government expected the Bank to fully communicate such efforts to the public at home and abroad.

(3) The government and the Bank shared the view that overcoming deflation was the top-priority task in Japan, and had been making policy efforts while sufficiently exchanging views and keeping close contact. On July 10, 2012, the Ministerial Council on Exiting Deflation released its first report, which aimed to realize a virtuous economic cycle and the growth accompanying an increase in income.

(4) The Bank had been conducting monetary policy based on its stance that, for the time being, it would pursue powerful monetary easing with the aim of achieving the goal of 1 percent in terms of the year-on-year rate of increase in the CPI, and continue to do so until it judged the 1 percent goal to be in sight. Nevertheless, according to the Bank's interim assessment of the April 2012 Outlook Report discussed at this meeting, the projected rates were still below 1 percent. The government was of the view that the Bank's measures proposed at this meeting aimed to steadily increase the amount outstanding of the Program. It expected the Bank to continue to conduct monetary policy vigorously and decisively for the purpose of achieving not only the projected rates presented in the interim assessment discussed at this meeting but also the goal of 1 percent, while closely monitoring developments in financial markets at home and abroad and working sufficiently on its communication to the public in an effort to make its policy stance fully understood.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was on the way to recovery at a moderate pace. As for the outlook, movement toward sound recovery was expected to take hold. However, there were risks of further slowdowns in overseas economies that could stem from the European debt problem, and of electric power supply constraints. Particular attention should be paid to the fact that central banks in other countries were conducting monetary easing measures to address downside risks to their respective economies.

(2) Although the Japanese economy remained in a mild deflationary situation, the government considered that the current circumstances provided a good opportunity for the economy to overcome deflation, since the rate of decline in prices had recently been moderating and the negative output gap was expected to continue to narrow. In order to overcome deflation decisively, a challenge Japan had confronted for a long period, it

was extremely important to deal with the structural factors in the Japanese economy that tended to generate deflation, while also implementing monetary policy measures.

(3) On July 10, 2012, the Ministerial Council on Exiting Deflation released its first report, which presented policy areas the government -- while remaining aware of the economic situation through fiscal 2013 -- placed importance on, with the aim of overcoming deflation. The government would do its utmost to overcome deflation by employing policy measures -- such as the budget for fiscal 2013 as well as tax and regulatory reforms -- in the areas presented in this report. The government would also formulate the "Strategy for Rebirth of Japan" and reinforce measures aimed at overcoming deflation and raising the growth potential.

(4) In the Bank's interim assessment of the April 2012 Outlook Report, the projected rates of increase in the CPI were still below 1 percent, the rate the Bank aimed to achieve for the time being. The government deemed it particularly important to produce visible results by achieving an inflation rate of 1 percent as promptly as possible. The government was making its best efforts to secure stable financial resources for social security functions and at the same time achieve fiscal consolidation. In the discussion of bills related to the comprehensive reform, the importance of economic growth, including the overcoming of deflation, was often highlighted, suggesting that the overcoming of deflation was a critical challenge. The government expected the Bank to continue powerful monetary easing until the exit from deflation was ensured. Given that the current circumstances provided a good opportunity for the economy to overcome deflation, it also expected the Bank to conduct monetary policy decisively in parallel with the government measures.

V. Votes

A. Vote on the Guideline for Money Market Operations

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

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

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

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

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

2. A public statement will be decided separately.

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

B. Vote on "Amendment to 'Principal Terms and Conditions for the Asset Purchase Program'"

With a view to proceeding with monetary easing in a continuous manner by steadily increasing the amount outstanding of the Program, members shared the view that it was appropriate to make the following changes with respect to the Program: (1) a reduction of about 5 trillion yen in the maximum amount outstanding of the fixed-rate operation and an increase of about 5 trillion yen in outright purchases of T-Bills; (2) a removal of the minimum bidding yield for outright purchases of T-Bills and CP; and (3) an integration of loan durations, which were currently "3 months" or "6 months," into "within 6 months" under the fixed-rate operation. "Amendment to 'Principal Terms and Conditions for the Asset Purchase Program'" was then put to a vote. Members voted unanimously to approve the amendment and agreed that the decision should be made public accordingly.

VI. Discussion on the Statement on Monetary Policy

On the basis of the above discussions, members discussed the Statement on Monetary Policy, which included a description of measures that would contribute to steadily increasing the amount outstanding of the Program, 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 1).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 14 and 15, 2012 for release on July 18, 2012.

Attachment 1

July 12, 2012

Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote, to set the following guideline for money market operations for the intermeeting period:

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

2. Overseas economies have shown some, albeit moderate, improvement, but on the whole still have not emerged from a deceleration phase. In global financial markets, some nervousness continues to be seen, mainly due to concern about the European debt problem. Particular attention should therefore be given to developments in these markets for the time being.

3. Japan's economic activity has started picking up moderately as domestic demand remains firm mainly supported by reconstruction-related demand. Public investment has continued to increase. Business fixed investment has been on a moderate increasing trend with improvement in corporate profits. Against the background of improvement in consumer sentiment, private consumption has continued to increase moderately due to the effects of measures to stimulate demand for automobiles. Housing investment has generally been picking up. Exports have shown signs of a pick-up. Reflecting these developments in demand at home and abroad, production has started picking up moderately with some fluctuations. Under these circumstances, business sentiment has been improving moderately particularly in domestic

demand-oriented sectors. Meanwhile, financial conditions in Japan have continued to ease. On the price front, the year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent.

4. As for the outlook, Japan's economy is expected to return to a moderate recovery path as domestic demand remains firm and overseas economies emerge from the deceleration phase. The year-on-year rate of change in the CPI is expected to remain at around 0 percent for the time being.

5. Compared with the forecasts presented in the April 2012 *Outlook for Economic Activity and Prices*, growth prospects will likely remain broadly unchanged. With regard to prices, the year-on-year rate of change in the domestic corporate goods price index will likely be somewhat lower for fiscal 2012 but broadly in line with the April forecasts for fiscal 2013. The year-on-year rate of change in the CPI (all items less fresh food) is expected to be broadly in line with the April forecasts.

6. Regarding risks to the economic outlook, there remains a high degree of uncertainty about the global economy, including the prospects for the European debt problem, the momentum toward recovery for the U.S. economy, and the likelihood of emerging and commodity-exporting economies simultaneously achieving price stability and economic growth. Regarding risks to the price outlook, careful attention should be paid to future developments in international commodity prices and in medium- to long-term inflation expectations.

7. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. This challenge will be met through efforts by a wide range of economic agents to strengthen the economy's growth potential and support from the financial side. Based on this recognition, the Bank has been providing support to strengthen the foundations for economic growth and pursuing powerful monetary easing. The Bank continues to conduct monetary policy in an appropriate manner. The Bank will also do its utmost

to ensure the stability of Japan's financial system, while giving particular attention to developments in global financial markets.

8. Recently, undersubscription (i.e., aggregate bids falling short of the Bank's offers) has taken place in the Bank's fixed-rate funds-supplying operation against pooled collateral and some other purchases. At the Monetary Policy Meeting held today, the Policy Board decided to adopt the following measures with the view to proceeding with the aforementioned monetary easing in a continuous manner by steadily increasing the amount outstanding of the Asset Purchase Program.[7]

   (1) A reduction in the maximum outstanding amount of the Bank's fixed-rate funds-supplying operation against pooled collateral by about 5 trillion yen and an increase in the outright purchases of treasury discount bills by about 5 trillion yen

   (2) A removal of the minimum bidding yield (currently 0.1 percent per annum) for the outright purchases of treasury discount bills and CP in order to ensure their smooth purchases

   (3) An integration of loan durations (currently "3 months" or "6 months") into "within 6 months" under the fixed-rate funds-supplying operation against pooled collateral in order to respond flexibly to liquidity demand by financial institutions

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[7] See Attachment 2 for an overview of the Asset Purchase Program.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (all items less fresh food)
Fiscal 2012	+2.2 to +2.4 [+2.2]	-0.3 to 0.0 [-0.2]	+0.1 to +0.3 [+0.2]
Forecasts made in April 2012	+2.1 to +2.4 [+2.3]	+0.4 to +0.7 [+0.6]	+0.1 to +0.4 [+0.3]
Fiscal 2013	+1.6 to +1.8 [+1.7]	+0.6 to +0.8 [+0.6]	+0.5 to +0.7 [+0.7]
Forecasts made in April 2012	+1.6 to +1.8 [+1.7]	+0.7 to +0.9 [+0.8]	+0.5 to +0.7 [+0.7]

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 with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates.

4. Forecasts for the domestic CGPI made in April 2012 are on the 2005 base, and those made in July 2012 are on the 2010 base.

5. The CPI using the Chain-Weighted Index Formula has also been released as a reference. Based on this chain-weighted index, the year-on-year rate of change in the CPI around fiscal 2013 may be slightly lower than the above forecasts based on the Fix-Weighted Index Formula.

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

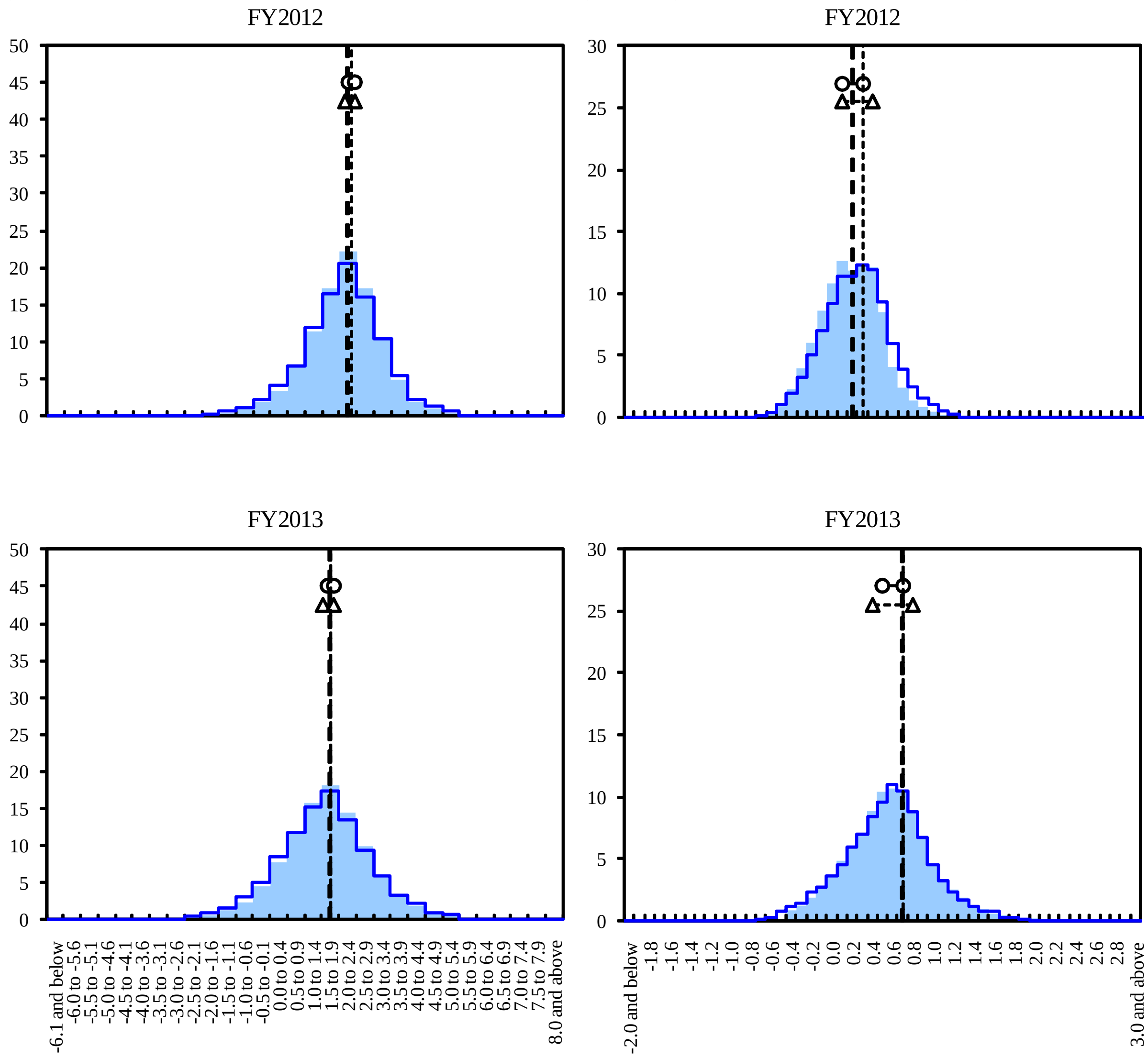
y/y % chg.

	Real GDP	Domestic CGPI	CPI (all items less fresh food)
Fiscal 2012	+2.1 to +2.4	-0.5 to 0.0	+0.1 to +0.4
Forecasts made in April 2012	+2.1 to +2.4	+0.3 to +0.8	+0.1 to +0.4
Fiscal 2013	+1.5 to +1.8	+0.5 to +1.0	+0.4 to +0.8
Forecasts made in April 2012	+1.5 to +1.8	+0.6 to +1.0	+0.4 to +0.8

Risk Balance Charts

(1) Real GDP

(2) CPI (All Items Less Fresh Food)



Notes: 1. Vertical axes in the charts represent probability (%), while horizontal axes represent the year-on-year percentage changes in the respective indicators. Bar charts represent the probability distributions in July 2012, and solid lines represent those in April 2012.

2. Heavy vertical dashed lines indicate the median of the Policy Board members' forecasts (point estimates). O———O indicates the range of the forecasts of the majority of Policy Board members. Δ-------Δ indicates the range of the forecasts of all Policy Board members.

3. Thin vertical dashed lines indicate the median of the Policy Board members' forecasts (point estimates) in April 2012.

4. 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*.

Attachment 2

Size of the Asset Purchase Program

(trillion yen)

	Program size at the time of establishment (October 2010)	Program size before today's decision		Program size after today's decision		Change in amount
(Intended timescale for completing the purchases)	(End-December 2011)	(End-December 2012)	(End-June 2013)	(End-December 2012)	(End-June 2013)	
		(A)		(B)		(B) - (A)
Total size	**About 35**	**About 65**	**About 70**	**About 65**	**About 70**	—
Asset purchases	5. 0	35. 0	40. 0	40. 0	45. 0	+5. 0
JGBs[Note]	1. 5	24. 0	29. 0	24. 0	29. 0	—
Treasury discount bills	2. 0	4. 5	4. 5	9. 5	9. 5	+5. 0
CP	0. 5	2. 1	2. 1	2. 1	2. 1	—
Corporate bonds	0. 5	2. 9	2. 9	2. 9	2. 9	—
Exchange-traded funds (ETFs)	0. 45	1. 6	1. 6	1. 6	1. 6	—
Japan real estate investment trusts (J-REITs)	0. 05	0. 12	0. 12	0. 12	0. 12	—
Fixed-rate funds-supplying operation against pooled collateral	30. 0	30. 0	30. 0	25. 0	25. 0	-5. 0
Three-month term	20. 0	20. 0	20. 0	—	—	—
Six-month term	10. 0	10. 0	10. 0	—	—	—

Note: In addition to purchases under the Asset Purchase Program, the Bank regularly purchases JGBs at the pace of 21.6 trillion yen per year.