

Not to be released until 2:00 p.m.  
Japan Standard Time on Thursday,  
July 20, 2006.

July 20, 2006

Bank of Japan

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# **Minutes of the Monetary Policy Meeting**

on June 14 and 15, 2006

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(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, June 14, 2006, from 2:00 p.m. to 4:01 p.m., and on Thursday, June 15, from 9:00 a.m. to 12:06 p.m.<sup>1</sup>

#### **Policy Board Members Present**

**Mr. T. Fukui, Chairman, Governor of the Bank of Japan**

**Mr. T. Muto, Deputy Governor of the Bank of Japan**

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

**Ms. M. Suda**

**Mr. S. Nakahara**

**Mr. H. Haru**

**Mr. T. Fukuma**

**Mr. A. Mizuno**

**Mr. K. G. Nishimura**

#### **Government Representatives Present**

Mr. K. Akaba, Senior Vice Minister of Finance, Ministry of Finance<sup>2</sup>

Mr. K. Sugimoto, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance<sup>3</sup>

Mr. Y. Nakajo, Vice Minister for Policy Coordination, Cabinet Office

#### **Reporting Staff**

Mr. M. Shirakawa, Executive Director

Mr. A. Yamamoto, Executive Director

Mr. A. Horii, Executive Director (Assistant Governor)<sup>4</sup>

Mr. M. Amamiya, Director-General, Monetary Affairs Department

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<sup>1</sup> The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on July 13 and 14, 2006 as "a document which contains an outline of the discussion at the meeting" stipulated in Article 20, Paragraph 1 of the Bank of Japan Law of 1997. Those present are referred to by their titles at the time of the meeting.

<sup>2</sup> Mr. K. Akaba was present on June 15.

<sup>3</sup> Mr. K. Sugimoto was present on June 14.

<sup>4</sup> Mr. A. Horii concurrently held the post of Director-General of the International Department.

Mr. S. Uchida, Senior Economist, Monetary Affairs Department

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

Mr. H. Hayakawa, Director-General, Research and Statistics Department

Mr. K. Momma, Deputy Director-General, Research and Statistics Department

#### Secretariat of the Monetary Policy Meeting

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

Mr. T. Koza, Adviser to the Governor, Secretariat of the Policy Board

Mr. K. Murakami, Director, Secretariat of the Policy Board

Mr. S. Shiratsuka, Senior Economist, Monetary Affairs Department

Mr. S. Yamaguchi, Senior Economist, Monetary Affairs Department

## **I. Summary of Staff Reports on Economic and Financial Developments<sup>5</sup>**

### **A. Money Market Operations in the Intermeeting Period**

The Bank conducted money market operations in accordance with the guideline decided at the previous meeting on May 18 and 19, 2006.<sup>6</sup> The uncollateralized overnight call rate was at effectively zero percent, although it temporarily edged somewhat higher in late May and the middle of June. The outstanding balance of current accounts at the Bank had been decreasing gradually, and was at around 10 trillion yen recently.

### **B. Recent Developments in Financial Markets**

In the money market, interest rates on term instruments rose. Interest rates on Euroyen futures fell, particularly in distant contract months.

Japanese stock prices declined from the previous month. The Nikkei 225 Stock Average was recently moving in the range of 14,000-14,500 yen.

Long-term interest rates decreased, mainly reflecting the decline in Japanese stock prices. Recently they were moving at around 1.8 percent.

The yen depreciated against the U.S. dollar due mainly to market participants' speculation regarding U.S. monetary policy. The yen was being traded at around 114 yen to the dollar recently.

### **C. Overseas Economic and Financial Developments**

The U.S. economy continued to expand at a pace around its potential growth rate, but the rate of growth was moderating recently. Although the pace of increase in the consumer price index (CPI) for all items was relatively fast due to high energy prices, the increase in the core inflation rate (the CPI for all items less food and energy) was moderate.

In the euro area, the momentum for economic recovery increased gradually as exports and production were increasing and household spending was emerging from its weak situation.

With regard to East Asian economies, in China both domestic and external demand

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<sup>5</sup> Reports were made based on information available at the time of the meeting.

<sup>6</sup> The guideline was as follows:

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

continued to expand strongly. The NIEs and ASEAN economies continued to expand at a moderate pace on the whole, although negative effects of high energy prices could be seen in some economic activity.

In U.S. and European financial markets, long-term interest rates fluctuated widely and stock prices were weak on the whole, partly reflecting speculation about the Federal Reserve's monetary policy for the near future. In many emerging economies also, stock prices continued to be weak.

## **D. Economic and Financial Developments in Japan**

### **1. Economic developments**

Exports had continued to increase against the background of the expansion of overseas economies, and were expected to continue to rise as overseas economies expanded further, particularly those of the United States and East Asia.

As for domestic private demand, business fixed investment had continued to increase, and was expected to keep increasing since the expansion in domestic and external demand and the high level of corporate profits were likely to be maintained.

Sales indicators related to private consumption had been sluggish recently. This seemed to be partly attributable to adverse weather conditions. On a GDP basis, real private consumption continued its steady increase.

Industrial production had continued to increase against the background of the growth in domestic and external demand. Production was expected to continue its uptrend, as overseas economies would continue to grow and the recovery in domestic demand would continue to be solid.

As for the employment and income situation, household income had continued rising moderately, reflecting improvements in employment and wages, in a situation where various indicators for labor market conditions had been improving. The gradual increase in household income was likely to continue.

Since the economic recovery had continued for more than four years, the conditions of persistent excess supply had been dispersed, and the output gap was currently close to zero and likely to gradually become positive.

On the price front, domestic corporate goods prices had continued to increase, mainly reflecting the rise in international commodity prices, and were expected to continue

increasing. The year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been on a positive trend, and this trend was projected to continue, as the output gap was likely to gradually become positive.

## 2. Financial environment

The environment for corporate finance was accommodative. The issuing environment for CP and corporate bonds was favorable, and the lending attitude of private banks had continued to be accommodative. The decline in credit demand in the private sector had come to a halt. Under these circumstances, the rate of increase in the amount outstanding of lending by private banks was accelerating, and the amount outstanding of CP and corporate bonds issued had been above the previous year's level. Funding costs for firms had risen slightly. Meanwhile, the year-on-year growth rate of the money stock ( $M_2$ +CDs) had been at the 1.0-2.0 percent level.

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

### A. Economic Developments

On the current state of Japan's economy, members agreed that it had generally followed the Bank's projection presented in the April *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). They concurred that Japan's economy continued to recover steadily, with domestic and external demand and also the corporate and household sectors well in balance, and said that it was expected to expand moderately.

Members agreed that overseas economies, particularly those of the United States and East Asia, continued to expand, and were likely to keep expanding.

On the U.S. economy, many members noted that, although it continued to expand at a pace around its potential growth rate, housing construction was cooling and some indicators for household spending and employment also suggested a slowdown in the pace of economic expansion. One member said that, despite the deceleration in housing investment and other indicators, the U.S. economy had been firm due to strong business investment in equipment and construction. Regarding price developments, many members expressed the view that the public had become more aware of inflation risk due to tight labor market conditions and high capacity utilization, coupled with the rise in prices of

commodities including oil. These members said that whether the economic deceleration in the United States would result in a soft landing, thereby containing concerns about inflation, was a focus of attention.

With regard to East Asian economies, members agreed that both domestic and external demand continued to expand strongly in China. One member commented that a key factor for developments in the Chinese economy was whether the recently started tightening of monetary policy could absorb excessive liquidity, thereby containing upside risks of investment activities and consumption.

On European economies, one member expressed the view that the momentum for a recovery had been increasing gradually, partly offsetting the adverse effect of the deceleration in the U.S. economy.

Regarding Japan's economy, members agreed that the increase in exports had continued, reflecting the expansion of overseas economies, and was likely to continue.

As for domestic private demand, members concurred that the strength in the corporate sector continued and this was benefiting the household sector.

With regard to developments in the corporate sector, members agreed that business fixed investment was likely to keep increasing, given that the perception among firms of having excess production capacity had dissipated and corporate profits remained high. Some members said that business fixed investment surged in the January-March quarter, according to the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and investment plans for fiscal 2006 were relatively strong in surveys. They continued that they would check the strength in business fixed investment in the June *Tankan* (Short-Term Economic Survey of Enterprises in Japan). Some members said that the pace of increase in profits for small and medium-sized firms was decelerating recently due partly to the rise in the cost of materials, and they would therefore pay attention to the effects of this slower increase in profits on developments in business fixed investment.

Members concurred that private consumption, which had been on an increasing trend, was likely to continue to recover steadily, mainly reflecting a gradual increase in household income. One member said that the recent sluggishness in sales indicators might have been caused by the fall in stock prices in addition to adverse weather conditions.

Members agreed that production had continued to increase and was likely to increase further against the background of the growth in domestic and external demand.

Members also concurred that inventories had been more or less in balance with shipments in the industrial sector as a whole. Some members said that, although the pace of increase in inventories of electronic parts and devices had decelerated somewhat, they would watch for a possible adjustment in inventories partly because demand related to the World Cup had been weaker than expected.

As for the employment and income situation, members agreed that the number of employees and wages had been increasing, and household income had continued to rise moderately, in a situation where labor market conditions had continued to improve and firms were more aware of the shortage of labor. Some members said that, besides firms' stance of restraining labor costs, the reason for regular payments being somewhat weak recently was the continuing effects of changes, which had been made in January, in samples used in the *Monthly Labour Survey*, and that wages had been rising gradually as a trend.

With regard to prices, members agreed that domestic corporate goods prices, which had been increasing due mainly to the rise in international commodity prices, were likely to continue to increase.

Members agreed that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) was likely to continue to follow a positive trend, as the output gap gradually became positive reflecting the steady economic recovery and as downward pressure from unit labor costs weakened due to the rise in wages. A few members pointed out that revisions of some services prices at the turn of the fiscal year had affected recent price developments, and said that the uptrend of the CPI was becoming firmly established as it was being caused by the rise in prices of a wide range of goods and services, rather than only certain items.

As for land prices, one member noted that the year-on-year rate of change in the urban land price index (average for all types of land) in the six large city areas registered a 3.8 percent rise, the first positive figure in 15 years. The member expressed the view that, although land prices were currently consistent with the expected return, careful monitoring would be required to check how the accommodative monetary policy affected them.

## **B. Financial Developments**

On the financial front, members concurred that the financial environment in terms of corporate finance, such as the lending attitude of private banks and the issuing



environment for CP and corporate bonds, remained extremely accommodative, although there were large swings in financial markets at home and abroad.

Many members said that the decline in stock prices was being widely observed in major industrial countries and emerging economies, albeit to differing degrees, and described the decline as basically an adjustment following the considerable increase since the second half of 2005. A few members added that prices of some international commodities, such as nonferrous metals, showed similar developments. Many members said that investors had been losing their risk appetite in a situation where monetary policy had entered a different phase worldwide. Many members commented that concerns about inflation and a slowdown in the U.S. economy had recently been highlighted and this was affecting current movements in stock prices. However, some of these members expressed the view that the decline in stock prices should not necessarily be taken as an indication of some sort of a change in the global economy, since there had not been any essential change in economic fundamentals worldwide or in Japan thus far. With regard to the effects of developments in stock prices on the future path of the economy, some members expressed the view that, if stock prices faced a long or a large adjustment, it could negatively affect the economy through, for example, changes in public sentiment. As a result of these discussions, members concurred that they would carefully monitor developments in international financial markets, including their impact on the economy.

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

On the monetary policy stance for the immediate future, members agreed that, based on their assessment of the economic and financial situation, it was appropriate to maintain the current guideline for money market operations that the Bank would encourage the uncollateralized overnight call rate to remain at effectively zero percent.

Members concurred that, as long as developments in economic activity and prices followed the Bank's projection presented in the April Outlook Report, it would be appropriate to conduct monetary policy in line with the thinking described in it. On this basis, most members said that, although developments in economic activity and prices had so far been generally in line with the projection presented in the Outlook Report, the Bank should continue to assess the economic and financial environment, including developments in financial markets worldwide and the U.S. economy. One of these members added that,

as economic activity and prices were not facing an imminent upside risk, there was still time for the Bank to carefully assess the economic and financial environment. One member commented that it would be appropriate for the Bank to decide to maintain the current guideline for money market operations at this meeting, since the Bank needed to monitor whether interest rates in the money market were being formed in a stable manner and should conduct monetary policy carefully in order not to surprise market participants. This member added, however, that in terms of the current economic fundamentals the foundation for raising interest rates had already been laid. Another member said that the Bank should take policy action at an appropriate time, given that the difference between the trend of real GDP growth rate and real short-term interest rates had been expanding further and monetary policy had become more stimulative.

Members agreed that, despite small temporary increases in short-term interest rates, taken as a whole, developments in the money market had been generally stable in the process of reducing the outstanding balance of current accounts at the Bank and it had been reduced without difficulty. Many members said that, as a result of the reduction of the balance, the proper functioning of the call market had been steadily restored, as seen in the fact that interest rates had shown some fluctuations reflecting market conditions and the volume of market transactions had been gradually increasing. They said that in this situation it was no longer difficult for the Bank to control the uncollateralized overnight call rate through money market operations, and in this sense the reduction of the current account balance had virtually been completed. In relation to this, one member commented that the Bank should, in some way, inform the market that the reduction of the current account balance had virtually been completed. Many members said that the Bank should continue to adjust the current account balance through money market operations, responding to changes in various factors such as the supply-demand balance of funds in the market and liquidity positions of individual financial institutions. They said that the Bank should explain to market participants that, under the current scheme of controlling the uncollateralized overnight call rate, such an adjustment of the current account balance did not reflect any policy intention.

A few members said that, although the proper functioning of the money market had been gradually restored, the Bank should encourage market participants to increase their preparedness for a change in the market environment because there was still room for

improvement, for example, in setting of credit lines to secure liquidity.

Members discussed what level the loan rate for the complementary lending facility should be. Many members noted that, while a narrow spread between the overnight call rate target and the complementary lending facility's loan rate might hinder restoration of the proper functioning of the money market, it would have the positive effect of stabilizing market interest rates in a situation where the functioning of the money market was not sufficiently restored. In this situation, members agreed that the Bank should endeavor to find the appropriate degree of spread between the target and the loan rate.

#### **IV. Remarks by Government Representatives**

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

- (1) Japan's economy was recovering, as seen in the recently released second preliminary estimate of GDP for the January-March quarter, which indicated that the real GDP growth rate was 0.8 percent on a quarter-on-quarter basis. However, the effects of developments in oil prices on domestic and overseas economies required careful monitoring, as they remained at high levels. A comprehensive review of developments in prices suggested that the price situation was improving gradually, although the economy had not yet overcome deflation. The government considered that it was necessary to ensure that this improvement continued. The government would like the Bank, together with the government, to continue policy efforts to ensure the sustainability of the economic recovery and the overcoming of deflation to prevent the economy from weakening again.
- (2) Financial markets had been experiencing some instability, for example, the recent plunge in stock prices. Therefore, the environment surrounding the financial markets would require careful monitoring.
- (3) Regarding the monetary policy stance for the immediate future, the government would like the Bank to firmly support the economy from the financial side by maintaining a zero interest rate environment and give due consideration to developments in financial markets.
- (4) Furthermore, in order to prevent financial markets from becoming unstable due to speculation regarding future monetary policy, the government would like the Bank to clearly explain its thinking regarding the future course of monetary policy to market

participants and the public.

The representative from the Cabinet Office made the following remarks.

- (1) Japan's economy was recovering. Although the continuous decline in prices, in other words deflation, persisted, the price situation had been showing some improvement. In order to accelerate and deepen structural reforms, the government would compile "Basic Policies for Economic and Fiscal Management and Structural Reform" for fiscal 2006, a Cabinet statement that aimed to strengthen economic growth and competitiveness as well as improve the fiscal position.
- (2) The Bank had been maintaining an accommodative financial environment by encouraging the uncollateralized overnight call rate to remain at effectively zero percent, taking consistency with the government's basic policy for the economy fully into consideration. The government would like to request that the Bank, in its conduct of monetary policy, continue its policy efforts alongside those of the government by supporting the economy from the financial side responsibly, giving due consideration to downside risk to economic activity and prices as well as developments in financial markets, so that the government's important policy goal of overcoming deflation in fiscal 2006 would be achieved. To prevent the financial markets from becoming unstable due to speculation regarding the future conduct of monetary policy, the government hoped that the Bank would explain more clearly its view on economic activity and prices and its outlook, thereby making it easier for market participants and the public to form an economic outlook and stabilizing their expectations.

## **V. Votes**

Based on the above discussions, members agreed that it was appropriate to maintain the current guideline for money market operations, which encouraged the uncollateralized overnight call rate to remain at effectively zero percent.

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

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

The guideline for money market operations for the intermeeting period ahead will be as follows, and will be made public by the attached statement (see Attachment 1).

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

Votes for the proposal: Mr. T. Fukui, Mr. T. Muto, Mr. K. Iwata, Ms. M. Suda, Mr. S. Nakahara, Mr. H. Haru, Mr. T. Fukuma, Mr. A. Mizuno, and Mr. K. G. Nishimura.

Votes against the proposal: None.

### **VI. Discussion on the Bank's View of Recent Economic and Financial Developments**

Members discussed "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments* (consisting of "The Bank's View" and "The Background"), and put it to the vote.

The Policy Board decided, by unanimous vote, the text of "The Bank's View." It was confirmed that "The Bank's View" would be published on June 15, 2006 and the whole report on June 16, 2006.<sup>7</sup>

### **VII. Approval of the Minutes of the Monetary Policy Meetings**

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of April 28, 2006 and May 18 and 19 for release on June 20, 2006.

### **VIII. Approval of the Scheduled Dates of the Monetary Policy Meetings in July-December 2006**

At the end of the meeting, the Policy Board approved the dates of the Monetary Policy Meetings to be held in the period July-December 2006, for immediate release (see Attachment 2).

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<sup>7</sup> The English version of the whole report was published on June 19, 2006.

Attachment 1

June 15, 2006

Bank of Japan

At the Monetary Policy Meeting held today, the Bank of Japan decided, by 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 effectively zero percent.

June 15, 2006

Bank of Japan

**Scheduled Dates of Monetary Policy Meetings  
in July-December 2006**

	Date of MPM	Publication of Monthly Report (The Bank's View)	Publication of MPM Minutes
July 2006	13 (Thur.), 14 (Fri.)	14 (Fri.)	Aug. 16 (Wed.)
Aug.	10 (Thur.), 11 (Fri.)	11 (Fri.)	Sep. 13 (Wed.)
Sep.	7 (Thur.), 8 (Fri.)	8 (Fri.)	Oct. 18 (Wed.)
Oct.	12 (Thur.), 13 (Fri.)	13 (Fri.)	Nov. 21 (Tue.)
	31 (Tue.)	--	Dec. 22 (Fri.)
Nov.	15 (Wed.), 16 (Thur.)	16 (Thur.)	Dec. 22 (Fri.)
Dec.	18 (Mon.), 19 (Tue.)	19 (Tue.)	To be announced

Note: "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments* (Monthly Report) is scheduled to be published at 3:00 p.m. (this schedule is subject to change on certain grounds such as late closing of the meeting).

Full text of the Monthly Report will be published at 2:00 p.m. on the next business day of the publication of "The Bank's View" (English translation will be published at 4:30 p.m. on the second business day of the publication of "The Bank's View").

"The Bank's View" in the *Outlook for Economic Activity and Prices* (October 2006) will be published at 3:00 p.m. on Tuesday, October 31, 2006 (the whole report including the background will be published at 2:00 p.m. on Wednesday, November 1).