

Not to be released until 2:00 p.m.
Japan Standard Time on Tuesday,
January 23, 2007.

January 23, 2007

Bank of Japan

Minutes of the Monetary Policy Meeting on December 18 and 19, 2006

(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 Monday, December 18, 2006, from 2:00 p.m. to 4:00 p.m., and on Tuesday, December 19, from 9:00 a.m. to 12:22 p.m.¹

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 Japan²

Ms. M. Suda

Mr. H. Haru

Mr. T. Fukuma

Mr. A. Mizuno

Mr. K. G. Nishimura

Mr. T. Noda

Government Representatives Present

Mr. K. Tanaka, Senior Vice Minister of Finance, Ministry of Finance³

Mr. E. Katsu, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance⁴

Mr. J. Hamano, Vice Minister for Policy Coordination, Cabinet Office

Reporting Staff

Mr. N. Inaba, Executive Director

Mr. A. Horii, Executive Director (Assistant Governor)

Mr. K. Ido, Executive Director

¹ The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on January 17 and 18, 2007 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.

² Mr. K. Iwata was absent from 9:00 a.m. to 9:23 a.m. on December 19 to attend the Ministerial Meeting on Economic Measures.

³ Mr. K. Tanaka was present on December 19.

⁴ Mr. E. Katsu was present on December 18.

Mr. M. Amamiya, Director-General, Monetary Affairs 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. E. Maeda, Deputy Director-General, Research and Statistics Department
Mr. T. Idesawa, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. Y. Nakayama, Director-General, Secretariat of the Policy Board
Mr. Y. Iino, Adviser to the Governor, Secretariat of the Policy Board
Mr. K. Shigyoh, Director, Secretariat of the Policy Board
Mr. N. Oda, Senior Economist, Monetary Affairs Department
Mr. N. Takeda, Senior Economist, Monetary Affairs Department

I. Summary of Staff Reports on Economic and Financial Developments⁵

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 November 15 and 16, 2006.⁶ The uncollateralized overnight call rate had been at around 0.25 percent.

B. Recent Developments in Financial Markets

In the money market, interest rates on Euroyen had risen and those on three-month financing bills (FBs) had fluctuated substantially. Interest rates on Euroyen futures had remained essentially unchanged on the whole.

Japanese stock prices had risen, partly due to the release of some firm economic indicators. The Nikkei 225 Stock Average was recently in the range of 16,500-17,000 yen.

Long-term interest rates had been fluctuating somewhat, mainly due to the release of some Japanese economic indicators and interest rate movements in the United States, and they were recently in the range of 1.65-1.70 percent.

The yen appreciated temporarily to the 114-115 yen level against the U.S. dollar and then depreciated, partly reflecting releases of U.S. economic indicators. It was recently being traded in the range of 117-119 yen.

C. Overseas Economic and Financial Developments

The U.S. economy continued to expand, but the pace of growth was decelerating. Housing investment continued to decrease and private consumption was decelerating moderately, while business fixed investment continued to increase. In this situation, the pace of increase in production and in the number of employees was slowing moderately. As for prices, the pace of increase in the consumer price index (CPI) for all items had recently moderated with the fall in energy prices. Core inflation as measured by change in the CPI for all items less food and energy had recently decelerated somewhat, but the

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 0.25 percent.

year-on-year rate continued to be in the range of 2.5-3.0 percent, mainly reflecting tighter supply-demand conditions due to the economic expansion.

In the euro area, economic recovery had become evident, as the increase in production and improvement in corporate profits had led to recovery in business fixed investment and private consumption. The U.K. economy continued to show stable growth.

With regard to East Asian economies, in China both domestic and external demand continued to expand strongly. The rate of increase in fixed asset investment remained high, although it was slowing somewhat, and private consumption, exports, and production remained on an uptrend. The NIEs and ASEAN economies continued to expand at a moderate pace, as both domestic and external demand were firm on the whole.

In U.S. financial markets, long-term interest rates and stock prices had been more or less unchanged, reflecting mixed developments in recently released economic indicators. In Europe, long-term interest rates had been more or less unchanged. Stock prices rebounded after the fall caused by the appreciation of the euro. In many emerging economies, stock prices continued to rise, marking record highs in several economies.

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 taken as a whole continued to expand.

As for domestic private demand, business fixed investment had continued to increase, and was expected to keep increasing since the growth in domestic and external demand and the high level of corporate profits were likely to be maintained. Business fixed investment plans in the December *Tankan* (Short-Term Economic Survey of Enterprises in Japan) were also strong.

Private consumption had been on an increasing trend, although the pace of increase had been only modest. Indicators related to services consumption, such as sales in the food service industry and outlays for travel, had been firm. Indicators related to the consumption of goods, such as sales at department stores and supermarkets, continued to lack momentum for recovery partly due to unfavorable weather. Private consumption was expected to follow an uptrend, mainly reflecting the gradual increase in household income.

Production had continued to increase against the background of the growth in domestic and external demand. Inventories as a whole had been more or less in balance with shipments. Inventories of electronic parts and devices, however, had accumulated due to weaker-than-expected demand for new game consoles and for cellular phones for sale in Japan. Although attention should be paid to developments in IT-related sectors, the upward trend in production was expected to continue as overseas economies continued to grow and domestic demand kept expanding.

With regard to the employment and income situation, household income had continued rising moderately in a situation where various indicators showed tighter labor market conditions. Regarding wages, changes in regular payments had been at around zero percent on a year-on-year basis, but overtime payments had continued to rise moderately. The gradual increase in household income was likely to continue against the background that firms were increasingly feeling a shortage of labor and corporate profits were expected to remain high.

On the price front, international commodity prices declined in the period from the summer to the early autumn, but remained high in a situation where global demand was on an increasing trend. Domestic corporate goods prices had been increasing at a slower pace due to the drop in crude oil prices, and for the immediate future, with the effects of the drop remaining, they were expected to be somewhat lower than or about the same as their levels of three months earlier. The year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been on a positive trend. This trend was projected to continue, as the output gap continued to be positive.

2. Financial environment

The environment for corporate finance continued to be accommodative. The issuing environment for CP and corporate bonds was favorable, and the lending attitudes of private banks had continued to be accommodative. Credit demand in the private sector had been increasing. Under these circumstances, the amount outstanding of lending by private banks had been increasing. The amount outstanding of CP and corporate bonds issued was slightly below the previous year's 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 concurred that the economy continued to expand moderately, and was likely to experience a sustained period of growth with a virtuous circle of production, income, and spending in operation. They also agreed that it was nevertheless important to continue to carefully examine incoming economic indicators as well as other relevant information, because indicators such as those for private consumption and consumer prices had recently been relatively weak.

Members concurred that overseas economies taken as a whole continued to expand, with more economies gaining momentum, and were likely to keep expanding.

On the U.S. economy, members agreed that, despite a substantial cooling in housing investment, the deceleration of growth in private consumption remained moderate mainly reflecting the increase in household income and the drop in gasoline prices. A few members expressed the view that the U.S. economy was becoming more likely to realize a soft landing, given that there were some signs of a bottoming out in housing sales and indicators related to retail sales were strong. With regard to recent developments in private consumption, some members commented that Christmas sales had made a relatively good start. Some other members said, however, that future developments in housing investment were still uncertain and growth in manufacturing sector activity seemed to be slowing, as suggested by the decline in the Purchasing Managers' Index (PMI) for the manufacturing sector compiled by the Institute for Supply Management (ISM).

As for prices, some members said that it was necessary to watch closely whether, with the current pace of slowing of the economy, core inflation moderated, given that core inflation remained relatively high and there was a widespread view that the potential growth rate of the U.S. economy had declined.

Based on the above discussion, members concurred that the U.S. economy was likely to grow at a rate modestly below its potential for a time, and eventually realize a soft landing in which the economy would be on a growth path around its potential growth rate. They also agreed, however, that both upside and downside risks should continue to be borne in mind.

Regarding Japan's economy, members agreed that exports had continued to

increase, reflecting the expansion of overseas economies, and were likely to continue to increase.

As for domestic private demand, members concurred that, in the corporate sector, profits continued to be at high levels and sentiment continued to be favorable. Members shared the view that business fixed investment continued to increase and indicators such as business fixed investment plans in the December *Tankan* suggested that it was likely to keep increasing, reflecting the continuation of growth in domestic and external demand and also of the high level of corporate profits. Many members said that, in the *Tankan*, the diffusion indices for business conditions of small firms and nonmanufacturing firms improved and their business fixed investment plans were revised upward. They continued that this confirmed that these two kinds of positive developments were spreading to a wide range of firms. A few members expressed the view that firms were making investments based on a careful evaluation of their profitability, and thus the level of the capital stock was not excessive.

Members shared the view that private consumption had been on an increasing trend, although the pace of increase had been only modest. They also concurred that private consumption was likely to continue to increase, mainly reflecting the gradual increase in household income. Many members commented that the relative weakness since the summer in indicators related to retail sales and in the GDP-based figure for private consumption was partly due to temporary factors, such as unfavorable weather, consumers' reluctance to buy before the introduction of new products, and fluctuations that were difficult to analyze in consumption-related statistics, but the weakness was also to some extent a result of the slow increase in wages and the pause until the early autumn in the rise in stock prices. One member said that the decline in households' real income due to the rise in crude oil prices might have adversely affected private consumption. A few members noted that the diffusion index for current business conditions in industries related to private consumption in the December *Tankan* was slightly weak and said that this seemed to reflect the moderate growth in private consumption since the summer. Some members, however, said that more firms in these industries were forecasting better business conditions and private consumption showed signs of improvement as seen in indicators such as those in the October *Family Income and Expenditure Survey* and the Synthetic Consumption Index. Many members were of the view that private consumption was likely to remain on

an increasing trend, mainly reflecting the increase in household income, but attention should be paid to future developments, including year-end sales.

Members agreed that production had continued to increase and was likely to continue to be on an increasing trend against the background of the growth in domestic and external demand. Many members said that inventories had been more or less in balance with shipments in the industrial sector as a whole. They said, however, that lately the shipment-inventory balance of electronic parts and devices had deteriorated slightly, and that this was caused by an accumulation of inventories due to weaker-than-expected demand for cellular phones and new game consoles. In relation to this, one member said that the environment surrounding orders for semiconductor manufacturing equipment had been deteriorating somewhat in North America, and the effects of this on production of IT-related goods in Japan should be watched closely. Some members commented that an adjustment in production was less likely to be serious since demand for IT-related goods, especially from overseas, had recently been firm on the whole. They added, however, that attention should be paid to future developments in final demand, including the results of Christmas sales in the United States and year-end sales in Japan, because they were highly uncertain.

As for the employment and income situation, members discussed the wage growth, which remained low. A few members noted that the sluggish growth in regular payments was partly due to the fact that, in view of intensifying global competition, firms were maintaining a cautious stance with regard to increases in regular payments, which were very similar in nature to fixed costs. A few other members expressed the view that the slow increase in the figures in the wage statistics seemed to be the result of a decrease in the average wage level due to the retirement of elderly workers who accounted for a large proportion of personnel, and regular payments actually received by an individual worker might be increasing, albeit gradually. Some members added that the positive influence of the strength in the corporate sector was gradually feeding through into the household sector via various channels, including increases in the number of employees, the wages of part-time and temporary workers, bonus payments, and dividends. In relation to this, a few members added that payments of retirement benefits would increase due to the retirement of elderly workers, and this could support consumption. Regarding the outlook for wages, some members said that the diffusion index for employment conditions in the

December *Tankan* indicated that firms expected that they would increasingly feel a shortage of labor, and how this affected the wage negotiations in spring 2007 should be watched closely. One member noted that the assessment of employment conditions in the *Tankan* only reflected the view of the corporate side, and to determine whether there was any slack in the labor market, it was necessary to conduct a comprehensive assessment of employment conditions by also carefully examining supply-side factors such as the labor force participation rate and the proportion of part-time workers.

Members noted that the year-on-year growth rate of real GDP for fiscal 2005 had been revised downward in the annual revision of the GDP data, from 3.3 percent to 2.4 percent. A few members pointed out that this downward revision had lowered the level of GDP for the last quarter before the start of fiscal 2006, and this would lower the year-on-year growth rate for fiscal 2006 even if the economy grew in line with projections on a quarter-on-quarter basis. They added that estimates of the potential growth rate might also decrease, reflecting the downward revision of the real GDP growth rate. One member said that the recently revised GDP data, such as the figures for fiscal 2005 and the second preliminary estimates for the July-September quarter of 2006, could suggest the possibility of a subtle change in the seasonal pattern of production and consumption and that this possibility should be borne in mind when looking at the GDP data.

With regard to prices, members agreed that, compared with the levels of three months earlier, domestic corporate goods prices had been about the same, due to the drop in crude oil prices, and they were likely to be somewhat lower or about the same.

Members concurred that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been on a positive trend, although the rate of increase had recently been slowing due to the decline in crude oil prices, and that the positive trend was likely to continue, as the output gap continued to be positive. Many members said that the year-on-year rate of increase in the CPI had been relatively low in October but might have accelerated slightly in November, because of the disappearance of the negative contribution from the previous year's fall in cellular telephone charges, although the positive contribution from prices of petroleum products continued to decrease. One member noted that, looking at price movements in October by item, the number of items whose price change from a year earlier turned positive exceeded the number of items whose price change turned negative. The member continued that prices of the items in the CPI

basket continued to show upward movement on the whole, but the pace was very slow.

Many members said that it was more important to assess the price formation mechanism properly through fiscal 2007 than to simply watch developments in the CPI. These members added that further analysis of the basic mechanism of price developments should be carried out, taking into account such factors as a possible revision of unit labor costs (labor costs per unit of output) and the estimated potential growth rate as a result of the revision of the GDP data.

B. Financial Developments

On the financial front, members reaffirmed their view that the financial environment remained accommodative as seen in the fact that the lending attitudes of private banks and the issuing conditions in capital markets were favorable. One member expressed the view that the financial environment had recently been becoming steadily more accommodative, judging from the relationship between the degree of improvement in the economy and the level of short-term interest rates.

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 around 0.25 percent.

Some members noted the fact that, in the money market, the uncollateralized overnight call rate had been stable despite large fluctuations in the supply-demand balance of funds in the market, and said that trading in the money market had been smooth, partly because market participants had become more accustomed to trading in the current financial environment and the Bank had been conducting money market operations flexibly.

Regarding the future path of monetary policy, members agreed that they would continue to assess economic activity and prices carefully, and that if developments in economic activity and prices were likely to follow the Bank's projection presented in the October 2006 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), it would be appropriate to conduct monetary policy in line with the thinking described in it that the Bank would adjust the level of the policy interest rate gradually in the light of

developments in economic activity and prices. Members concurred that, although the fundamental mechanisms underlying economic activity and prices remained intact, further examination of incoming economic indicators as well as other relevant information was necessary given the fact that indicators such as those for private consumption and consumer prices had recently been relatively weak.

One member said that, if it was confirmed with more confidence in the interim assessment to be made at the next meeting that developments in economic activity and prices were most likely to follow the Bank's projection presented in the October Outlook Report, the Bank should implement a policy change. A few members said that the Bank did not need to rush into adjusting the level of interest rates, but if it became more certain about future developments in economic activity and prices, it should adjust the unprecedentedly low level of the policy interest rate at an appropriate time, at the meeting in January or later. A few other members commented that, in the process of adjusting the level of the policy interest rate, the Bank should judge the timing of any policy change appropriately, carefully examining various types of information until uncertainty about the outlook for economic activity and prices was dispelled to some extent.

Members referred to the fact that the timing of a possible policy change was increasingly attracting the attention of the public, including market participants. They agreed that it was still important for the Bank to carefully explain that it would judge the timing of any policy change appropriately, without any predetermined idea, by carefully assessing economic activity and prices based on up-to-date information.

IV. Remarks by Government Representatives

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

- (1) Japan's economy continued to recover, but developments should continue to be watched closely as the positive influence of the strength in the corporate sector on the household sector had recently weakened somewhat and some economic indicators such as those related to consumption showed weakness.
- (2) Prices were unlikely to decline continuously, but careful attention should continue to be paid to future price developments since factors such as the fall in crude oil prices were likely to continue to affect them.
- (3) Given the current developments in economic activity and prices, the government

considered that it was important that the Bank continue to firmly support the economy based on the Bank's current guideline for money market operations in order to achieve sustainable economic growth with price stability.

- (4) The government would like the Bank to give due consideration to developments in financial markets. In order to prevent financial markets from becoming unstable due to speculation regarding the future conduct of monetary policy, it would also like the Bank to clearly explain, based on the Bank's decisions at previous meetings, 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) Although Japan's economy was recovering despite some weakness in consumption, a close watch needed to be kept on the effects on price movements of developments in overseas economies.
- (2) The government released the "Fiscal 2007 Economic Outlook and Basic Stance for Economic and Fiscal Management" earlier in the day. Regarding economic developments in fiscal 2006, consumption had recently been showing some weakness and the positive influence of the strength in the corporate sector was feeding through into the household sector only at a very slow pace. The government expected that, in fiscal 2007, with the world economy continuing to recover steadily, both the corporate sector and the household sector would continue to improve, and Japan's economy would achieve autonomous and sustainable growth with price stability.
- (3) With regard to the outlook for economic activity and prices, the government considered that particular attention should be paid to downside risks, since key factors for the future course of Japan's economy would be how developments in crude oil prices and overseas economies affected the domestic economy and how the positive influence of the strength in the corporate sector fed through into the household sector, rather than upside risks.
- (4) In order to achieve sustainable economic growth led by private demand based on price stability, it was important for the government and the Bank to make joint efforts, with a shared basic perspective on macroeconomic management. As for the future path of monetary policy, the Bank had stated that it would maintain the accommodative financial conditions ensuing from very low interest rates for some time. The

government would like the Bank to implement effective monetary policy that was consistent with the government's policy efforts and with its outlook for the economy while paying due consideration to developments in financial markets, and to support the economy from the financial side responsibly, taking into account downside risks to the outlook for economic activity and prices.

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 around 0.25 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 around 0.25 percent.

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

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 a unanimous vote, the text of "The Bank's View." It was confirmed that "The Bank's View" would be published on December 19, 2006 and the whole report on December 20, 2006.⁷

⁷ The English version of the whole report was published on December 21, 2006.

VII. Approval of the Minutes of the Monetary Policy Meetings

The Policy Board approved unanimously the minutes of the Monetary Policy Meetings of October 31, 2006 and November 15 and 16 for release on December 22, 2006.

VIII. Approval of the Scheduled Dates of the Monetary Policy Meetings in January-June 2007

At the end of the meeting, the Policy Board approved the dates of the Monetary Policy Meetings to be held in the period January-June 2007, for immediate release (see Attachment 2).

Attachment 1

December 19, 2006

Bank of Japan

At the Monetary Policy Meeting held today, 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 0.25 percent.

December 19, 2006

Bank of Japan

**Scheduled Dates of Monetary Policy Meetings
in January-June 2007**

	Date of MPM	Publication of Monthly Report (The Bank's View)	Publication of MPM Minutes
Jan. 2007	17 (Wed.), 18 (Thur.)	18 (Thur.)	Feb. 26 (Mon.)
Feb.	20 (Tue.), 21 (Wed.)	21 (Wed.)	Mar. 26 (Mon.)
Mar.	19 (Mon.), 20 (Tue.)	20 (Tue.)	May 7 (Mon.)
Apr.	9 (Mon.), 10 (Tue.)	10 (Tue.)	May 22 (Tue.)
 27 (Fri.)	--	June 20 (Wed.)
May	16 (Wed.), 17 (Thur.)	17 (Thur.)	June 20 (Wed.)
June	14 (Thur.), 15 (Fri.)	15 (Fri.)	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* (April 2007) will be published at 3:00 p.m. on Friday, April 27, 2007 (the whole report including the background will be published at 2:00 p.m. on Tuesday, May 1).