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March 26, 2007

Bank of Japan

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# **Minutes of the Monetary Policy Meeting**

on February 20 and 21, 2007

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

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Secretariat of the Policy Board, Bank of Japan

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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 Tuesday, February 20, 2007, from 2:00 p.m. to 4:03 p.m., and on Wednesday, February 21, from 9:00 a.m. to 2:15 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. 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 Finance<sup>2</sup>

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

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

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

Mr. S. Uchida, Senior Economist, 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 March 19 and 20, 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.

<sup>2</sup> Mr. K. Tanaka was present on February 21.

<sup>3</sup> Mr. E. Katsu was present on February 20.

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. Takeda, Senior Economist, Monetary Affairs Department

Mr. K. Suzuki, Senior Economist, Monetary Affairs Department

## **I. Summary of Staff Reports on Economic and Financial Developments<sup>4</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 January 17 and 18, 2007.<sup>5</sup> 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 and on three-month financing bills (FBs) had been more or less unchanged. Interest rates on Euroyen futures had also generally been unchanged.

Japanese stock prices had risen, mainly reflecting strong expectations of upward revisions in firms' earnings forecasts. The Nikkei 225 Stock Average was recently in the range of 17,500-18,000 yen.

Long-term interest rates declined temporarily, but then increased reflecting the rise in Japanese stock prices. They were recently in the range of 1.70-1.75 percent.

The yen had appreciated against the U.S. dollar, mainly because some Japanese economic indicators had been stronger than market forecasts. It was recently being traded in the range of 119-121 yen to the dollar.

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

The U.S. economy continued to expand, but the pace of growth was decelerating moderately with some fluctuations. Business fixed investment continued to be on an uptrend, although the pace of increase was slowing. Meanwhile, housing investment continued to decrease. Private consumption had been relatively firm recently, but continued to be on a decelerating trend. In this situation, the pace of increase in production and in the number of employees was slowing moderately. As for prices, the consumer price index (CPI) for all items was slightly higher than in the previous month, mainly due to the rise in energy prices. The core CPI (the CPI for all items less food and

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<sup>4</sup> Reports were made based on information available at the time of the meeting.

<sup>5</sup> The guideline was as follows:

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

energy) continued to increase moderately, mainly reflecting tighter supply-demand conditions due to the economic expansion.

In the euro area, economic recovery continued to be solid, as the increase in production and improvement in corporate profits had led to recovery in business fixed investment and private consumption.

In China, both domestic and external demand continued to expand strongly. The rate of increase in fixed asset investment remained high, although it had slowed somewhat. Exports continued to show a substantial increase, and private consumption and production also remained on an uptrend. The NIEs and ASEAN economies continued to expand at a moderate pace on the whole, although a pause in the increase in exports had been observed recently.

In financial markets, long-term interest rates in the United States had been more or less unchanged. U.S. stock prices had been rising, mainly due to strong corporate earnings. In Europe, long-term interest rates had been rising slightly; stock prices had also been increasing, basically reflecting the rise in U.S. stock prices. In emerging economies, the relative weakness observed in financial markets at the beginning of the year had abated and stock prices and currencies had returned to an uptrend in many 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 levels of corporate profits were likely to be maintained.

Private consumption had been firm. Sales at department stores and supermarkets had been relatively weak, weighed down by sluggish sales of winter apparel due to the unseasonably warm weather. Sales of electrical appliances, however, had shown a clear increase recently. As for services consumption, sales in the food service industry had continued to trend upward, and outlays for travel, especially overseas travel, had generally been firm. The index of living expenditure level in the *Family Income and Expenditure*

*Survey* recovered in the October-December quarter, and the private consumption figure in the GDP statistics rebounded in the October-December quarter after decreasing in the July-September quarter. Private consumption was expected to follow a gradual 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 had been more or less in balance with shipments in the industrial sector as a whole. However, inventories of electronic parts and devices had remained at a high level relative to shipments. In addition, inventories of automobiles accumulated temporarily toward the end of 2006 because automobiles awaiting shipment overseas built up and production outpaced actual domestic sales. The upward trend in production as a whole was expected to continue, reflecting the rise in domestic and external demand, with overall inventories more or less in balance with shipments. Interviews with firms suggested that production in the January-March quarter of 2007 was likely to decrease marginally, after the upsurge in the October-December quarter of 2006. Taking the two quarters together, production was considered to remain on an upward trend.

With regard to the employment and income situation, various indicators had continued to show tighter labor market conditions. Wages had been on a gradual uptrend, but some weakness had been observed recently. This was due to the fact that firms were still restraining labor costs, and might have also been attributable to the retirement of the baby-boomer generation, whose wage levels were relatively high. Household income had continued rising moderately, supported by the increase in the number of employees. 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, crude oil prices had experienced relatively large swings, temporarily dropping sharply at the start of the year but then bouncing back reflecting the fall in temperatures in the United States. Prices of nonferrous metals had remained high on the whole, but prices of copper and zinc had been falling lately. Compared with three-month-earlier levels, domestic corporate goods prices had recently been somewhat lower and were likely to continue to be somewhat lower in the immediate future, due to the drop in international commodity prices. The year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been registering small increases. It

might be around zero in the short run, mainly due to the drop in crude oil prices. From a longer-term perspective, however, it was projected to continue to follow a positive trend, as the output gap continued to be positive.

## 2. Financial environment

The environment for corporate finance was 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. The year-on-year rate of change in the money stock ( $M_2+CDs$ ) was around 1.0 percent.

## 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 it continued to expand moderately, and was likely to experience a sustained period of growth as a virtuous circle of production, income, and spending was likely to remain intact.

Members agreed that overseas economies taken as a whole continued to expand, with more economies gaining momentum, and were likely to keep expanding. Members also concurred that the likelihood of the U.S. economy realizing a soft landing was increasing and thus uncertainty about the outlook for overseas economies had abated.

On the U.S. economy, members agreed that the adjustments in the housing market, which were still ongoing, had not affected a wide range of areas of the economy, and that private consumption had been firm recently, mainly reflecting the increase in household income and the drop in gasoline prices. As for the outlook, many members expressed the view that the likelihood of the U.S. economy realizing a soft landing was increasing, noting the following points. First, regarding the adjustments in the housing market, there were signs of a bottoming out in sales indicators. Second, indicators relating to employment and retail sales were firm. Third, the decline in crude oil prices was expected to enhance households' real purchasing power. And fourth, the corporate sector as a whole was likely



to continue to be firm, although somewhat cautious views were becoming more prevalent about the outlook for the manufacturing industry. At the same time, many members added that both upside and downside risks should continue to be borne in mind, given that the likely extent of future adjustments in the housing market was still uncertain and the core inflation rate (the CPI for all items less food and energy) remained relatively high.

With regard to European economies, members agreed that economic recovery continued to be solid in the euro area. A few members were of the view that the increase in the value-added tax rate in Germany had had only a limited impact on, for example, consumption. On East Asian economies, members concurred that the Chinese economy continued to expand strongly and the NIEs and ASEAN economies continued to expand at a moderate pace on the whole.

One member noted that crude oil prices rose again in the intermeeting period and expressed the view that they should continue to be watched carefully giving due consideration to factors such as developments in inventories of crude oil in the United States and geopolitical risks.

Regarding Japan's economy, members concurred 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 shared the view that business fixed investment continued to increase and was likely to keep increasing, reflecting the ongoing growth in domestic and external demand and also the continuing high level of corporate profits. One member, while noting that some firms, particularly in the semiconductor industry, seemed to be reducing or delaying fixed investment, said that business fixed investment as a whole had continued to increase without any signs of overinvestment.

Members agreed that private consumption had been firm and was likely to follow a gradual uptrend, mainly reflecting the gradual increase in household income. Many members said that private consumption was unlikely to exhibit a substantial increase given that some indicators relating to it had continued to be relatively weak. However, they said it had been confirmed that the decline in consumption indicators in summer 2006 was due to temporary factors, such as unfavorable weather, consumers' reluctance to buy before the introduction of new products, and a statistical anomaly in those indicators. Some of these members noted that, although sales of winter apparel had been sluggish due to the

unseasonably warm weather, sales of electrical appliances, particularly digital appliances, new game consoles, and cellular phones, had increased and added that services consumption had been firm on the whole. A few members referred to the fact that the private consumption figure in the GDP statistics increased in the October-December quarter and commented that this increase supported the view that the sluggishness in the July-September quarter had been only temporary. One member also noted that consumption expenditures in the *Family Income and Expenditure Survey*, which had been sluggish in the July-September quarter, improved in the October-December quarter to the April-June level, and that the index of shipments of consumer goods in the Indices of Industrial Production rose in the October-December quarter. A different member commented that the drop in gasoline prices and the rise in stock prices were also likely to support private consumption. In response to these views, one member said that attention should be paid to the relative weakness in private consumption, which was reflected in the fact that the private consumption figure in the GDP statistics for the October-December quarter showed a year-on-year rate of increase lower than the number of employees and that the growth in wages was only modest.

Members agreed that production had continued to increase and was likely to continue to be on an upward trend against the background of the rise in domestic and external demand. Some members noted, however, that production in the January-March quarter of 2007 was likely to decrease marginally, after the upsurge in the October-December quarter of 2006, when production of automobiles had increased substantially.

Members concurred that inventories had been more or less in balance with shipments in the industrial sector as a whole. Many members noted, however, that inventories of electronic parts and devices had been increasing. Some of these members said that attention should continue to be paid to developments in inventories of IT-related products even though the overall firmness of global demand for IT-related goods was likely to prevent inventory adjustments from becoming widespread. A different member noted that there might be a temporary pause in the growth of production in the future, especially in IT-related industries, given that inventory adjustments of liquid crystal displays might continue until around the summer although inventories of semiconductors were likely to peak out in February or March.

As for the employment and income situation, members concurred that household income had continued rising moderately in a situation where various indicators had continued to show tighter labor market conditions. They also agreed that 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.

Given the above employment and income situation, members concurred that nominal wages per worker had been on a gradual uptrend, but some weakness had been observed recently. Some members said that this was attributable to the fact that corporate management continued to restrain labor costs: and additionally, the increase in retirements in the baby-boomer generation, and possibly a reduction in salaries of local government employees, might be affecting nominal wages per worker recently. These members were nevertheless of the view that upward pressure on wages was likely to increase reflecting tighter labor market conditions. With regard to the spring wage negotiations, a few members expressed the view that more firms were likely to raise wages in the new fiscal year starting April 2007 than in the previous year. Some members were of the view that, despite the weakness in regular payments, the positive influence of the strength in the corporate sector was gradually feeding, albeit only moderately, into the household sector via various channels, such as increases in the number of employees, the wages of part-time and temporary workers, and dividends. On the other hand, one member said that, although wages of new graduates and part-time workers might increase in April, recent growth in wages had been slower than expected, and therefore attention should be paid to possible downward pressure on private consumption and prices.

Some members commented that the first preliminary estimates of GDP for the October-December quarter supported the view that the sluggishness in private consumption in the July-September quarter had been only temporary, suggesting that Japan's economy was on a growth path of around 2 percent in real terms. On this point, one member expressed the view that the Bank's projection presented in the October 2006 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) was likely to materialize somewhat later than expected.

With regard to prices, members agreed that, compared with the levels of three months earlier, domestic corporate goods prices had been somewhat lower, due to the drop in international commodity prices, and they were likely to continue to be somewhat lower in

the immediate future.

Members concurred that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been registering small increases. They were of the view that it might be around zero in the short run, mainly due to the drop in crude oil prices, but from a longer-term perspective it was projected to continue to follow a positive trend, as the output gap continued to be positive.

Most members said that it was likely that the drop in crude oil prices would exert downward pressure on the year-on-year rate of change in the CPI for the immediate future, with the possibility of it temporarily registering zero percent or slightly below zero percent. Some of these members said that, in addition to the drop in crude oil prices, the introduction of new billing plans for cellular phones might exert downward pressure on the CPI. One of these members said that there were also factors that might exert upward pressure in the future, such as recently observed signs of an increase in services prices and an expected rise in imputed rent. In addition, another member commented that, in projecting future prices, recent developments that might exert upward pressure on prices should be taken into account and such developments included rises in the following: (1) prices of iron and nonferrous metals in Japan; (2) prices of raw materials imported from China; and (3) the general level of import prices, which reflected the yen's depreciation.

Taking the above discussion into consideration, many members expressed the view that it was more important to properly assess the fundamental environment surrounding prices than to simply watch developments in the CPI. Judging on this basis, these members said that the underlying trend of inflation pressures was likely to increase in the longer term because the utilization of resources such as production capacity and labor had been increasing and the economic expansion was expected to continue.

In relation to future developments in prices, one member commented that it was more difficult to grasp the trend in consumer prices with the new 2005-base CPI, which had been introduced last year. The member continued that the new index might be less sensitive to changes in the output gap than the old one. The member also said that the following points should be borne in mind: first, judging from corporate goods price indices, there was a possibility that the tightening of supply and demand conditions both at home and abroad had come to a halt; and second, unit labor costs might decline given the slow growth in wages.

As for developments in asset prices, one member said that demand for office space had been increasing in metropolitan areas and attention should be paid to the buoyancy in the real estate market. At the same time, this member expressed the view that taken as a whole land prices reflected fair value as firms had so far been making real estate investment based on careful evaluation of its profitability.

## **B. Financial Developments**

On the financial front, members agreed that the financial environment remained accommodative. They noted that the lending attitudes of private banks and the issuing conditions in capital markets were favorable. Some members commented that the yen remained on a depreciating trend. Another member noted that the volume of stock trading had been large and stock prices had been firm.

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

Based on their assessment of the economic and financial situation, members discussed the monetary policy stance for the immediate future.

The majority of members were of the view that, reviewing the outlook for Japan's economy based on incoming data and information, both on the domestic and overseas economies, a virtuous circle of production, income, and spending remained intact, and that it was becoming more likely that the economy would experience sustainable economic growth with price stability. They continued that, with the prospects of the economic and price situation improving, the stimulative effect of monetary policy, if the policy interest rate were kept at the current level, could gradually increase, and if expectation took hold, in such a situation, that interest rates would remain low for a long time regardless of economic activity and prices, there was a possibility that sustained economic growth would be hampered by misallocation of funds and resources through excess financial and economic activities. One of these members pointed out that the expected real rate of return in the medium to long term on investment in financial and fixed assets would recover as improvement in the economic situation became likely. The member continued that, in order to achieve sustainable economic growth with long-term price stability, real interest rates should be adjusted in line with the recovery in the expected real rate of return, thereby promoting efficient allocation of resources and funds.

On this basis, these members expressed their view on the guideline for money market operations for the intermeeting period ahead that it would be appropriate to raise the uncollateralized overnight call rate target from around 0.25 percent to around 0.5 percent, with a view to ensuring price stability in the medium to long term and achieving sustainable economic growth.

These members agreed that, if the Bank decided to raise the policy interest rate at this meeting, it should explain clearly that the decision was based on a forward-looking perspective, projecting developments in economic activity and prices for one to two years ahead: in other words, the Bank had made the decision from a longer-term perspective, taking full account of the possibility that the CPI might become sluggish and its year-on-year rate of change might even become negative in the short run. They also concurred that the Bank needed to make efforts to ensure full understanding among the public that the adjustment of interest rates at this meeting was not intended to constrain economic growth but to ensure sustainable growth by containing large economic swings. A few of these members added that it was important that the Bank explain that such forward-looking decisions were based on comprehensive examination of all relevant information, including economic indicators, gathered and accumulated until the day of the meeting, and were not based solely on developments in economic indicators since the previous month.

On the other hand, one member expressed the view that, from a forward-looking perspective, the Bank should maintain the uncollateralized overnight call rate target at around 0.25 percent because there was significant uncertainty regarding the future pace of increase in prices, given that the relative weakness in wages and private consumption had not been dispelled and that there was a likelihood of a temporary pause in the growth of production in the future although adjustments might be marginal. This member said that it would still not be too late to raise the policy interest rate after explaining the Bank's projections for prices including that for fiscal 2008 through, for example, the upcoming Outlook Report.

The members who advocated raising the uncollateralized overnight call rate target expressed the opinion that it would be appropriate to raise the basic loan rate, the loan rate for the complementary lending facility, from 0.4 percent to 0.75 percent if the Bank raised the uncollateralized overnight call rate target. Some of these members were of the view

that, given that the proper functioning of the money market had been gradually restored since the Bank had brought the zero interest rate environment to an end in July 2006, the Bank's stable control of the overnight call rate would not be hindered even if the spread between the overnight call rate target and the basic loan rate expanded a little wider from the current 0.15 percentage point to 0.25 percentage point.

With respect to the outright purchases of long-term interest-bearing Japanese government bonds, members agreed that it would be appropriate for the Bank to continue to purchase them at the current amount and frequency for some time, with due regard for the future condition of its balance sheet.

Members concurred that their basic thinking remained unchanged on the future course of monetary policy: the Bank would adjust the level of interest rates gradually in the light of developments in economic activity and prices, while maintaining the accommodative financial conditions ensuing from very low interest rates for some time. A few members said that the Bank should explain repeatedly that adjustment of interest rates would be implemented gradually in the light of developments in economic activity and prices, and would not be based on a predetermined time schedule.

Many members commented on the Bank's communication with market participants that the Bank should communicate, not the specific timing of a policy change, but its assessment of economic activity and prices and its basic thinking concerning the conduct of monetary policy. They emphasized the importance of the process of two-way communication on this basis between the Bank and market participants in which market participants would form their views regarding interest rates by comparing information provided by the Bank with their assessment of economic activity and prices, and in turn the Bank would obtain information about market participants' views on economic activity and prices from interest rates formed in financial markets. One member said that the Bank should aim to provide concise explanations when communicating to market participants.

#### **IV. Submission of Policy Proposals**

Based on the above discussions, the chairman formulated the following three policy proposals to reflect the majority view: (1) the guideline for money market operations; (2) a change in the basic discount rate and the basic loan rate; and (3) release of a public statement concerning a change in the guideline for money market operations.

**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, effective immediately from the announcement of the decision.

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

2. A public statement will be decided separately.

**The Chairman's Policy Proposal on a Change in the Basic Discount Rate and the Basic Loan Rate:**

1. The basic discount rate for discounting of bills pursuant to Article 33, Paragraph 1, Section 1 of the Bank of Japan Law and the basic loan rate for loans made pursuant to Article 33, Paragraph 1, Section 2 of the Law will be as follows, effective immediately from the announcement of the decision.

The basic discount rate and the basic loan rate will be changed to 0.75 percent.

2. A public statement will be decided separately.

**The Chairman's Policy Proposal on Release of a Public Statement concerning a Change in the Guideline for Money Market Operations:**

The decision concerning a change in the guideline for money market operations will be made public by the attached statement (see Attachment).

**V. Remarks by Government Representatives (Before the Votes)**

Following the chairman's proposals, including a proposal to change the guideline for money market operations, the representatives from the Ministry of Finance (MOF) and the Cabinet Office requested the chairman to adjourn the meeting because they needed to discuss the government's stance on the proposals and might need to contact the Minister of



Finance and the Minister of State for Economic and Fiscal Policy. The chairman approved the request. (The meeting adjourned at 1:01 p.m. and reconvened at 1:26 p.m.)

After the meeting reconvened, the representative from the MOF made the following remarks.

- (1) The chairman had submitted a proposal to raise the policy interest rate target from 0.25 percent to 0.50 percent. The government's basic thinking was that, as it had repeatedly stated, it would like the Bank to support the economy from the financial side so as to ensure the sustainability of the economic recovery, given the current situation with regard to economic activity and prices. While this was the government's thinking, it would respect the Policy Board's decision to change its policy since the Bank was in charge of making specific decisions on the conduct of monetary policy.
- (2) The government would like the Bank to continue to implement appropriate monetary policy consistent with the government's economic policy.

The representative from the Cabinet Office made the following remarks.

- (1) The government considered that Japan's economy continued to recover, but as it had repeatedly stated, private consumption was almost flat in a situation where the pace of growth in income had been decelerating and the positive influence of the strength in the corporate sector on the household sector had recently weakened somewhat. Furthermore, the diffusion index for current economic conditions in the *Economy Watchers Survey* had been lower than 50 -- the threshold indicating that respondents saw no change in economic conditions -- for three consecutive months, and the leading index in the Indexes of Business Conditions had also been lower than 50 percent for two consecutive months. The first preliminary estimates of the real GDP for the October-December quarter of 2006 confirmed the recovery of the economy, but taking the average of the quarterly figures of the July-September and October-December quarters, the figure for private consumption was almost flat, indicating that consumption was still weak.
- (2) A comprehensive review of developments in prices suggested that the economy had not yet overcome deflation. There was a view that the year-on-year rate of change in the CPI (excluding fresh food) might become negative again. Price movements should

continue to be monitored carefully, taking into account developments in wages and private consumption as well as risks arising from, for example, developments in overseas economies.

- (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 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.
- (5) The chairman had submitted a proposal to raise the policy interest rate. The government considered that the current situation was critical because it was still uncertain whether the economy could finally overcome deflation with private consumption recently being weak, and the Bank should therefore firmly support Japan's economy from the financial side in a responsible manner and did not need to rush to raise the policy interest rate at this point. While understanding that specific decisions on the conduct of monetary policy were made by a majority vote of the Policy Board members at Monetary Policy Meetings, the government would like the Bank to pay due consideration to these points and decide on the policy change carefully.
- (6) The government would like the Bank to fulfill its accountability to the public by explaining its assessment of economic activity and prices leading to the Bank's decision to be made at this meeting and its view regarding the economy's path toward price stability.

## **VI. Votes**

The following three policy proposals submitted by the chairman were put to the vote: (1) the guideline for money market operations, proposed by the chairman; (2) a change in the basic discount rate and the basic loan rate, proposed by the chairman; and (3) release of a public statement concerning a change in the guideline for money market operations, proposed by the chairman.

The chairman's policy proposal on the guideline for money market operations was approved by an 8-1 majority vote.

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

Votes against the proposal: Mr. K. Iwata.

The chairman's policy proposal on a change in the basic discount rate and the basic loan rate was approved by an 8-1 majority vote.

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

Votes against the proposal: Mr. K. Iwata.

The chairman's policy proposal on release of a public statement concerning a change in the guideline for money market operations was approved by an 8-1 majority vote.

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

Votes against the proposal: Mr. K. Iwata.

Mr. K. Iwata dissented from the above three proposals for the following reasons. First, there was significant uncertainty regarding the future pace of increase in prices, given that the relative weakness in wages and private consumption had not been dispelled and that there was a likelihood of a temporary pause in the growth of production in the future -- especially in IT-related industries -- although adjustments might be marginal. And second, it would be necessary for the Bank to clearly explain its projection for prices through, for example, the upcoming Outlook Report before a policy change.

## **VII. Remarks by Government Representatives (After the Votes)**

After the votes, the representative from the MOF made the following remarks.

(1) The Bank had decided to raise the policy interest rate target by 0.25 percentage point at

this meeting. To prevent financial markets from becoming unstable due to the policy change, the government would like the Bank to clearly explain issues that were attracting high interest among market participants, such as the Bank's thinking regarding the future course of monetary policy and its outright purchases of long-term Japanese government bonds.

- (2) The government considered it necessary to make public its response to the Bank's decision made at this meeting later in the day without waiting for the release of the minutes of this meeting, and hoped that the Bank would understand this.

The representative from the Cabinet Office made the following remarks.

- (1) The chairman's proposals had been put to the vote, and the Bank had decided to raise the policy interest rate target by a majority vote.
- (2) The government would like the Bank to fulfill its accountability to the public by explaining its assessment of economic activity and prices that had led to the Bank's decision made at this meeting and its view regarding the economy's path toward price stability.
- (3) The government would like to strongly request the Bank to continue 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 firmly support the economy from the financial side in a responsible manner by maintaining the accommodative financial conditions ensuing from very low interest rates, taking into account downside risks to the outlook for economic activity and prices.
- (4) The Cabinet Office might make public later in the day its response to the Bank's decision made at this meeting, without waiting for the release of the minutes of this meeting, and hoped that the Bank would understand this.

### **VIII. 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 February 21, 2007 and the whole report on February 22, 2007.<sup>6</sup>

**IX. Approval of the Minutes of the Monetary Policy Meeting**

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of January 17 and 18, 2007 for release on February 26, 2007.

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<sup>6</sup> The English version of the whole report was published on February 23, 2007.

February 21, 2007

Bank of Japan

### **Change in the Guideline for Money Market Operations**

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

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

2. With respect to the complementary lending facility, the Bank decided, by an 8-1 majority vote,<sup>[Note 2]</sup> to change the basic loan rate<sup>[Note 3]</sup> applicable under the facility to 0.75 percent (effective immediately). With respect to the outright purchases of long-term interest-bearing Japanese government bonds, purchases will continue at the current amount and frequency for some time, with due regard for future conditions of the Bank's balance sheet.
3. Reviewing the outlook for Japan's economy based on incoming data and information, both on domestic and overseas economies, the Bank judged that our economy is likely to continue its moderate expansion with a virtuous circle of production, income, and

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

Voting against the action: Mr. K. Iwata.

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

Voting against the action: Mr. K. Iwata.

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

spending in place. Uncertainties over the future course of overseas economies, including that of the United States, are abating, and this is likely to reinforce the prospects of continued increase in corporate profits and business fixed investment. With respect to private consumption, the weakness observed in the last summer seems temporary, and it is judged that private consumption is on a moderate increasing trend.

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

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