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May 7, 2007

Bank of Japan

Minutes of the Monetary Policy Meeting

on March 19 and 20, 2007

(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 Monday, March 19, 2007, from 2:00 p.m. to 4:06 p.m., and on Tuesday, March 20, from 9:00 a.m. to 12:36 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 Japan

Ms. M. Suda

Mr. H. Haru

Mr. T. Fukuma

Mr. A. Mizuno

Mr. K. G. Nishimura

Mr. T. Noda

Government Representatives Present

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

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

¹ The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on April 27, 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.

Mr. M. Ayuse, Deputy Director-General, Monetary Affairs Department²
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. H. Kanno, Director, Monetary Affairs Department²
Mr. N. Takeda, Senior Economist, Monetary Affairs Department
Mr. H. Koguchi, Director, Financial Markets Department²

² Messrs. M. Ayuse, H. Kanno, and H. Koguchi were present on March 20 from 9:00 a.m. to 9:14 a.m.

I. Summary of Staff Reports on Economic and Financial Developments³

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 February 20 and 21, 2007.⁴ The uncollateralized overnight call rate had been at around 0.5 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, particularly those with distant contract months, had fallen.

Japanese stock prices had declined, reflecting the fall in global stock prices and the appreciation of the yen. The Nikkei 225 Stock Average was recently in the range of 16,500-17,000 yen.

Long-term interest rates had declined, reflecting the fall in stock prices worldwide, including those in Japan, and the decline in U.S. long-term interest rates. They were recently in the range of 1.55-1.60 percent.

The yen had appreciated against the U.S. dollar, mainly because market participants had adjusted their positions reflecting the fall in global stock prices. It was recently being traded in the range of 115-118 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. Housing investment continued to decrease. Private consumption had been firm recently, but continued to be on a decelerating trend. Business fixed investment continued to be on an uptrend reflecting the high level of corporate profits, although the pace of increase was slowing. As for prices, the rate of increase in the consumer price index (CPI) for all items had recently risen, reflecting developments in energy prices. The core CPI (the CPI for all items less food and energy) continued to increase moderately,

³ Reports were made based on information available at the time of the meeting.

⁴ The guideline was as follows:

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

mainly reflecting tighter supply-demand conditions due to the economic expansion.

In the euro area, economic recovery continued to be solid, with domestic and external demand well in balance.

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 as domestic demand remained firm, despite a lull in exports.

In financial markets, a plunge in the Chinese stock market in late February caused renewed concerns among market participants about the downside risk to the U.S. economy, leading to a substantial fall in stock prices in the United States, Europe, and emerging economies. Long-term interest rates had declined in the United States and Europe. In emerging economies, many currencies had depreciated against the yen.

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 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.

Private consumption had been firm. Sales at department stores and supermarkets for January showed considerable improvement, assisted by favorable New Year and clearance sales. Sales of electrical appliances had been steady lately. 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. Private consumption was expected to follow a gradual uptrend, mainly reflecting the gradual increase in household income.

Production had been on an increasing trend against the background of the growth in domestic and external demand. It decreased marginally in January, largely in reaction to the high growth in the October-December quarter of 2006. Inventories had been more or less in balance with shipments in the industrial sector as a whole, although inventories of

electronic parts and devices had been at a high level relative to shipments. Under these circumstances, production was likely to decrease marginally in the January-March quarter of 2007 but was considered to remain on an upward trend, reflecting the rise in domestic and external demand.

With regard to the employment and income situation, various indicators had continued to show tighter labor market conditions. Some sluggishness had recently been observed in wages. 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 recently been around the level of late December, having bounced back after temporarily dropping sharply at the start of the year. Compared with three-month-earlier levels, domestic corporate goods prices had recently been somewhat lower and were likely to continue to be somewhat lower or stay about the same 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) was around zero percent, and was expected to continue to be around zero percent 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. Amendment to Guidelines on Eligible Collateral

A. Staff Proposal

The staff proposed that the Bank amend Guidelines on Eligible Collateral to reflect the dissolution of the Government Housing Loan Corporation and the establishment of its successor, the Japan Housing Finance Agency, scheduled for April 1, 2007. This amendment concerned collateral prices of residential mortgage-secured pass-through notes issued by the corporation and those to be issued by the agency.

B. Discussion by the Policy Board and Vote

Members voted unanimously to approve the proposal and agreed that the decision should be made public.

III. 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 concurred that the U.S. economy as a whole continued to expand moderately as private consumption kept increasing steadily, although housing investment continued to decrease. Many members said that the risks associated with the adjustments in the housing market should continue to be watched carefully given that concerns about the increase in delinquency rates for subprime mortgage loans had been rising recently. Some members commented that attention should also be paid to the risk of an increase in non-subprime mortgage loan delinquency rates and to the effects of the disposal of foreclosed assets on housing prices. One member added that the influence of the recent developments in subprime mortgage loans on overall consumer loans and the liquidity risks associated with securitized instruments backed by subprime mortgage loans also warranted attention. One member noted that although delinquency rates for mortgage loans were increasing, they were still at low levels compared with rates in the 1990s, and the increase

in delinquency rates for subprime mortgage loans had not been very widespread. Meanwhile, many members expressed the view that close attention should be paid to whether inflation pressures were contained, as the core CPI had been increasing moderately. Based on these discussions, members concurred that both upside and downside risks should continue to be borne in mind, although the current standard scenario was that the U.S. economy was likely to realize a soft landing in which the economy would approach its potential growth rate in or after the middle of 2007.

With regard to European economies, members agreed that economic recovery continued to be solid in the euro area, with domestic and external demand well in balance. A few members said that no significant impact of the increase in the value-added tax rate in Germany had so far been observed. On East Asian economies, members concurred that in China both domestic and external demand continued to expand strongly, as evidenced by developments such as the accelerating pace of growth in exports. They also agreed that the NIEs and ASEAN economies continued to expand at a moderate pace on the whole.

One member expressed the view that although crude oil prices had recently been around the level of late December, they should continue to be watched carefully since they could fluctuate widely depending on 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, as indicated by some sources such as the *Financial Statements Statistics of Corporations by Industry, Quarterly*, and was likely to keep increasing, reflecting the ongoing growth in domestic and external demand and also the continuing high level of corporate profits.

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 commented that indicators for January relating to retail sales, such as sales at department stores and supermarkets, showed improvement, adding that sales at department stores for February also seemed to have been favorable. Meanwhile, one member noted that there were increasing regional differences in the momentum of growth in consumption

and added that these increasing differences should be borne in mind when assessing the underlying trend.

Members expressed the view that production had remained on an increasing trend even though it had recently decreased marginally in reaction to the upsurge in the October-December quarter of 2006. They also said that production was likely to continue to be on an upward trend against the background of the rise in domestic and external demand.

Members concurred that inventories had been more or less in balance with shipments in the industrial sector as a whole, although inventories of electronic parts and devices had been at a high level relative to shipments. Some members expressed the view that, although global demand for IT-related goods remained firm and the risk that adjustment in inventories might become widespread seemed small, attention should continue to be paid to developments in inventories of electronic parts and devices since the pace of increase in production capacity tended to be rapid in this sector. One member said that, given the current developments in IT-related markets and orders for IT-related goods, the inventory adjustment in the IT-related sector might be more prolonged than expected.

As for the employment and income situation, members concurred that, in a situation where various indicators had continued to show tighter labor market conditions, household income had continued rising moderately, supported by the increase in the number of employees. 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. With regard to developments in wages, a few members said that firms seemed to be maintaining a cautious stance on wage increases, as indicated by their offers in the wage negotiations in spring 2007. One member expressed the view that the recent sluggishness in the statistics for wages per worker was partly due to the following factors: a shift in the composition of the workforce from the elderly, whose wage levels were relatively high, to the young; the fact that employment was increasing mainly in industries where the average income was relatively low, such as services; and a reduction in the salaries of local government employees.

Members concurred that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) was likely to be around zero percent in the short run, mainly due to the drop in crude oil prices, but from a longer-term perspective it was likely

to continue to follow a positive trend as the output gap continued to be positive.

Many members said that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) for February might be slightly below zero percent due mainly to the effects of the past drop in crude oil prices and the introduction of low-cost billing plans for cellular phones. A few members expressed the view that there might be similar developments in March and for some time thereafter. Many members commented on the fundamental environment surrounding prices that, given the increase in the utilization of resources such as production capacity and labor, upward pressures on the CPI were likely to increase if the economy continued to grow at a rate exceeding its potential. One member said that attention should be paid to the possibility that the relationship between the increase in the output gap and the increase in the CPI might have changed in recent years, and to the fact that services prices were affected by wages in the nonmanufacturing sector.

As for developments in asset prices, one member commented that developments in the real estate market, including the data in *Land Price Publication* to be released shortly, should continue to be examined closely, as office rents in metropolitan areas were increasing. A different member said that there was further polarization in the real estate market, noting that the active buying and selling observed in some areas had not become widespread.

B. Financial Developments

On the financial front, members discussed the fall in global stock prices since late February. Many members were of the view that risk-taking activities of market participants might have become somewhat excessive in the wake of a further decline in market volatility, but any such behavior seemed to have been modified in response to the plunge in the Chinese stock market and some negative developments in the U.S. economy. One of these members added that accounting fraud involving some listed firms might have been one of the factors behind the decline in Japanese stock prices. Many members said that the appreciation of the yen since late February seemed to be attributable to position adjustments by market participants. Based on the above discussions, members agreed that although the fall in global stock prices since late February did not seem to suggest a change in global economic trends, developments in financial markets continued to warrant close

attention since they could influence economic activities.

IV. 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 0.5 percent. One member commented on the policy change in February that the Bank could have waited until it had fully explained its assessment of economic activity and prices in the April 2007 *Outlook for Economic Activity and Prices* (hereafter the Outlook Report). The member continued that it would nevertheless be appropriate to maintain the current guideline for money market operations for the following reasons. First, reversing policies frequently could cause unnecessary confusion in the market. And second, the present policy interest rate of around 0.5 percent seemed warranted for the purpose of maintaining and strengthening the proper functioning of the money market.

As for developments in the money market since the policy change in February, many members said that the Bank had managed the uncollateralized overnight call rate at around 0.5 percent well, albeit with a temporary rise in the rate toward the end of February. These members were of the view that market participants had adapted smoothly to the policy change without significantly altering their view regarding the future course of interest rates, as evident in the fact that interest rates on term instruments had been more or less unchanged.

Members concurred that it would be appropriate to keep their basic thinking on the future course of monetary policy unchanged: 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, under the system in which decisions were made by votes after thorough discussion among the Policy Board members, the information that the Bank should provide was its

assessment of economic activity and prices and its basic thinking concerning the conduct of monetary policy. They also said that the Bank should make efforts to further promote understanding of this point among market participants. Many members referred to the importance of providing the market with appropriate information in conducting forward-looking monetary policy based on the "New Framework for the Conduct of Monetary Policy." From this point of view they thought, after discussing its views thoroughly and formulating them, the Bank should explain clearly, in the April 2007 Outlook Report, whose projection period covered until fiscal 2008, the outlook for economic activity and prices and its risk assessment, and the basic thinking based on them concerning the conduct of monetary policy. One member added that the Bank should again explain well in the April 2007 Outlook Report the relationship between its "understanding of medium- to long-term price stability" and its conduct of monetary policy.

V. 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 been somewhat weak: private consumption, for example, had been almost flat since the second half of 2006.
- (2) Although consumer prices were unlikely to decline continuously, careful attention should be paid to them. This was because the year-on-year rate of change in the CPI had been around zero percent due to factors such as the fall in crude oil prices and might become negative in the near future.
- (3) Given that it would take time for the rise in the policy interest rate, which was decided by the Bank at the previous Monetary Policy Meeting, to take effect in the economy, the government would like the Bank to continue to support the economy from the financial side based on the Bank's current guideline for money market operations.
- (4) As for developments in financial markets, some fluctuations had been observed in stock prices and foreign exchange rates since late February. The government would continue to pay close attention to financial market developments, and it would like the Bank to give due consideration to them as well. In order to prevent financial markets from becoming unstable due to speculation regarding the future conduct of monetary

policy, the government would also like the Bank to clearly explain its assessment of economic activity and prices and 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 the government considered that Japan's economy continued to recover, 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. A comprehensive review of developments in prices suggested that the economy had not yet overcome deflation. 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.
- (2) 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.
- (3) 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. The government would like to request 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 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 government would like the Bank to fulfill its accountability to the public by explaining its view regarding the economy's path toward price stability in the April 2007 Outlook Report, in which the outlook for economic activity and prices for two years ahead through fiscal 2008 would be presented after being discussed at the Monetary Policy Meeting on April 27, 2007.

VI. 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 0.5 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 0.5 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.

VII. 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 March 20, 2007 and the whole report on March 22, 2007.⁵

VIII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of February 20 and 21, 2007 for release on March 26, 2007.

⁵ The English version of the whole report was published on March 23, 2007.

IX. Approval of the Scheduled Dates of the Monetary Policy Meetings in April-September 2007

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

Attachment 1

March 20, 2007

Bank of Japan

At the Monetary Policy Meeting held today, the Bank of Japan decided, by a unanimous vote,^[Note] 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 0.5 percent.

^[Note] Voting for the action: 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.
Voting against the action: None.

March 20, 2007

Bank of Japan

**Scheduled Dates of Monetary Policy Meetings
in April-September 2007**

	Date of MPM	Publication of Monthly Report (The Bank's View)	Publication of MPM Minutes
Apr. 2007	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.)	July 18 (Wed.)
July	11 (Wed.), 12 (Thur.)	12 (Thur.)	Aug. 28 (Tue.)
Aug.	22 (Wed.), 23 (Thur.)	23 (Thur.)	Sep. 25 (Tue.)
Sep.	18 (Tue.), 19 (Wed.)	19 (Wed.)	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).