

Not to be released until 8:50 a.m.
Japan Standard Time on Monday,
April 14, 2008.

April 14, 2008

Bank of Japan

Minutes of the Monetary Policy Meeting

on March 6 and 7, 2008

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

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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 Thursday, March 6, 2008, from 2:00 p.m. to 4:27 p.m., and on Friday, March 7, from 9:01 a.m. to 12:48 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. A. Mizuno

Mr. K. G. Nishimura

Mr. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Government Representatives Present

Mr. H. Moriyama, Senior Vice Minister of Finance, Ministry of Finance²

Mr. M. Suzuki, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance³

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, Associate 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 8 and 9, 2008 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. H. Moriyama was present on March 7.

³ Mr. M. Suzuki was present on March 6.

Mr. T. Sekine, Senior Economist, Monetary Affairs Department
Mr. H. Nakaso, Director-General, Financial Markets Department
Mr. K. Momma, Director-General, Research and Statistics Department
Mr. E. Maeda, Associate Director-General, Research and Statistics Department
Mr. T. Idesawa, Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. K. Osugi, Director-General, Secretariat of the Policy Board
Mr. K. Shigyoh, Director, Deputy Head of Secretarial Services for the Board, Secretariat of the Policy Board
Mr. S. Yamaguchi, Senior Economist, Monetary Affairs Department
Mr. K. Suzuki, Senior Economist, Monetary Affairs Department

I. Summary of Staff Reports on Economic and Financial Developments⁴

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 14 and 15, 2008.⁵ As a result, the uncollateralized overnight call rate had been at around 0.5 percent.

B. Recent Developments in Financial Markets

In the money market, Euroyen rates and interest rates on term instruments, such as yields on financing bills (FBs) and treasury bills (TBs), had been more or less flat. Interest rates on Euroyen futures had been essentially flat, with some temporary increases.

Japanese stock prices fluctuated widely following unstable U.S. and European stock prices. The Nikkei 225 Stock Average had been moving at around 13,000 yen recently.

Long-term interest rates had fallen since the previous meeting, continuing to follow those in the United States and Europe. They had recently been at around 1.35 percent.

The yen appreciated against the U.S. dollar mainly due to growing concerns over an economic slowdown in the United States, and had recently been traded at around 103 yen against the dollar.

C. Overseas Economic and Financial Developments

A slowdown in the U.S. economy had become more evident as seen in the fact that indicators relating to employment and private consumption had been somewhat weak in a situation where adjustments in the housing market had persisted and financial institutions had tightened their lending standards. Business fixed investment remained on a gradual uptrend. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items had stayed elevated, and that in the CPI for all items less energy and food, or the core CPI, was at around 2.5 percent.

⁴ Reports were made based on information available at the time of the meeting.

⁵ The guideline was as follows:

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

The economy of the euro area continued to grow, although the pace of growth was slowing moderately. Business fixed investment was on an upward trend. Meanwhile, export growth seemed to be losing momentum. Housing investment continued to decelerate, and due to the rise in energy and food prices and to uncertainty about the outlook for the economy, private consumption was somewhat weak. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) continued to be relatively high, reflecting the rise in energy and food prices. The U.K. economy continued to grow, albeit with a moderate slowing of the pace of growth.

In China, both domestic and external demand continued to expand strongly. India's economy continued to show relatively high growth, although it was slowing moderately. The NIEs and ASEAN economies continued to expand at a moderate pace on the whole.

In global financial markets, a fall in prices of securitized products and a decrease in their market liquidity had continued amid persisting market concerns about the effects of possible further losses that financial institutions might incur and of downgrading of monoline insurers. Credit spreads such as corporate bond spreads and credit default swap (CDS) premiums had continued to widen. In the U.S. and European financial markets, stock prices fell slightly and long-term interest rates decreased, compared with the time of the previous meeting. In emerging economies, stock prices had fallen somewhat, and yield differentials between their sovereign bonds and U.S. Treasuries had expanded slightly, mainly due to the decline in U.S. interest rates.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had continued to increase against the background of the expansion of overseas economies. They rose substantially in January 2008 compared with the average level of the October-December quarter, after exhibiting high growth throughout the second half of 2007. Exports were expected to continue to rise, as overseas economies were likely to expand although at a slower pace.

As for domestic private demand, business fixed investment had continued to trend upward, as corporate profits had remained high although they were leveling off. Business fixed investment was expected to continue to trend upward since the increasing trend of

domestic and external demand and the generally high level of corporate profits were likely to be maintained.

Private consumption had been firm. With regard to durable consumer goods, sales of electrical appliances had continued to increase. The number of new passenger-car registrations had been picking up moderately since the summer of 2007, supported mainly by the successive introduction of new models. Sales at department stores and supermarkets, which primarily sold nondurable and semi-durable consumer goods, had been more or less unchanged on the whole. As for services consumption, outlays for travel had generally been firm, and sales in the food service industry had also been firm on the whole although they had lost momentum compared with some time ago. Consumer sentiment had become generally cautious, due mainly to rises in prices of petroleum products and food products and the weakness in stock prices. Private consumption was expected to follow a gradual uptrend, reflecting the gradual increase in household income.

Housing investment had remained at a low level, although there had been signs of recovery. The number of housing starts, a leading indicator of housing investment, was starting to clearly show a recovery. Housing investment was expected to recover gradually, although, with the effects of the revision of the Building Standard Law persisting, it was likely to remain sluggish for the time being.

Production had been more or less flat lately, partly in reaction to the relatively large increase in the second half of 2007. In light of developments in demand both at home and abroad, production was expected to remain more or less flat in the short run and increase thereafter. Inventories had been more or less in balance with shipments.

As for employment and income, household income had continued rising moderately, supported by the increase in the number of employees. Nominal wages per worker, however, had remained somewhat weak. The gradual increase in household income was likely to continue against the background that firms continued to feel a shortage of labor and corporate profits were expected to remain generally high.

On the price front, international commodity prices continued to increase. Crude oil prices had continued to be strong, partly due to the speculative inflow of funds. Prices of crops such as wheat had also continued to increase. Prices of nonferrous metals had been softening since the fall of 2007, partly due to concerns about a further slowdown in the U.S. economy, but they had recently rebounded. The three-month rate of change in the

domestic corporate goods price index (CGPI) had been positive, mainly due to the rise in international commodity prices, and the CGPI was likely to continue increasing for the time being. The year-on-year rate of change in the CPI (excluding fresh food) had been rising since around the end of 2007, and was projected to follow a positive trend due to the rise in prices of petroleum products and food products in the short run and the positive output gap in the longer run.

2. Financial environment

The environment for corporate finance was accommodative. Credit demand in the private sector had been more or less flat. The issuing environment for CP and corporate bonds had been favorable as a whole, although issuance spreads on those issued by firms with low credit ratings had expanded slightly. The lending attitudes of private banks had continued to be accommodative, and the amount outstanding of lending by private banks had been increasing moderately. The amount outstanding of CP and corporate bonds issued had been above the previous year's level. Funding costs for firms had been more or less unchanged. The year-on-year rate of growth in the money stock (M_2 +CDs) was around 2 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 agreed on the following assessment: the economy was expanding moderately as a trend, although the pace of growth was slowing mainly due to the drop in housing investment and the effects of high energy and materials prices; the virtuous circle of growth in production, income, and spending remained basically intact, and the economy was likely to continue expanding moderately, although the pace of growth was likely to slow for the time being; however, due attention should continue to be paid to factors such as uncertainty regarding future developments in overseas economies and global financial markets, and to the effects of high energy and materials prices.

Members agreed that, although overseas economies continued to expand, albeit at a slower pace, downside risks, particularly to the U.S. economy, had increased against the

background of the continuing instability of global financial markets.

Members said that adjustments in global financial markets had persisted and at the same time had intensified, reflecting uncertainties regarding future developments in the global economy in addition to market participants' concerns about further losses incurred by financial institutions and the creditworthiness of U.S. monoline insurers. Many members said that credit spreads such as corporate bond spreads and CDS premiums were widening further, and stock prices were fluctuating widely. Some of these members added that the adjustments stemming from the U.S. subprime mortgage problem had gradually spread to a broader range of products, including securitized products backed by commercial real estate loans and municipal bonds. One member commented that developments in money markets, which had remained stable since the end of 2007, warranted attention as interest rates on term instruments had recently begun rising again due to the widening of credit spreads. Based on the discussion, members agreed that they needed to continue to closely monitor developments in financial markets, which might be affected by financial statements of and capital reinforcement by U.S. and European financial institutions.

With regard to the U.S. economy, members concurred that a slowdown in the economy had become more evident. Many members said that adjustments in the housing market were still continuing as seen in the fact that the decline in home prices had accelerated amid the continued decline in housing starts and sales. Members agreed that private consumption had recently been more or less flat, while business fixed investment remained on a gradual uptrend. Some members said that deterioration in business and consumer sentiment had become more evident. Many members were concerned that financial institutions might incur further losses and consequent tightening of their lending standards might exert downward pressure on the U.S. economy. One of these members commented that there were growing concerns regarding the outlook for investment in commercial real estate, one of the driving forces of business fixed investment. Based on the above discussion, members shared the view that downside risks to the U.S. economy were growing. Meanwhile, some members added that the year-on-year rate of increase in both the CPI for all items and the core CPI had stayed elevated, and there remained inflationary risks.

With regard to European economies, members shared the view that the economy of the euro area continued to grow, although the pace of growth was slowing moderately.

Some members said that attention should be paid to the downside risks, particularly the effects of the disruptions in global financial markets and the consequent tightening of financial institutions' lending standards.

On Asian economies, members concurred that China and India continued to show high growth, and that the NIEs and ASEAN economies continued to expand at a moderate pace on the whole. One member expressed the view that, although it was certain that the deterioration in the U.S. economy would affect the global economy negatively, there would be a significant time lag before the effects materialized and the negative impact would not be great given that emerging economies were enjoying high growth led mainly by domestic demand.

Regarding global price developments, some members were of the opinion that there were upside risks worldwide given the surge in international commodity prices, particularly crude oil prices, caused mainly by vigorous demand from emerging economies and a speculative inflow of funds to the commodity markets. One of these members pointed out that there were growing concerns over inflation in U.S. and European financial markets.

Members concurred that Japan's exports had continued to increase, as overseas economies were expanding although at a slower pace, and they were likely to continue to increase. Some members noted that, although exports to the United States were decelerating, those to Europe, Asia, and the Middle East had remained strong. One of these members added that the uptrend in Japan's exports was likely to continue, although the pace of growth was likely to slow somewhat due to the global economic slowdown.

As for domestic private demand, members agreed that business fixed investment had continued to trend upward, as corporate profits had remained high although they were leveling off. They also shared the view that business fixed investment was likely to continue to trend upward since the increasing trend of domestic and external demand and the generally high level of corporate profits were likely to be maintained. Many members, however, commented that the growth of profits of firms, particularly small firms, was slowing reflecting the rise in materials prices and the appreciation of the yen, and it seemed that their stance on fixed investment had become cautious. A few members said that firms' profits and their stance on fixed investment for fiscal 2008 should be carefully monitored by, for example, examining the upcoming March *Tankan* (Short-Term Economic Survey of

Enterprises in Japan).

Members concurred that private consumption had been firm and was likely to follow a gradual uptrend, reflecting the gradual increase in household income. A few members noted that consumer sentiment had become cautious given the ongoing rise in the prices of daily necessities, such as petroleum products and food products. One member said that indicators relating to private consumption had been firm so far even though consumer sentiment had become cautious, and expressed the view that this was attributable partly to the fact that the employment situation remained favorable.

As for employment and income, members agreed that household income had continued rising moderately, supported by the increase in the number of employees. They also concurred that the gradual increase in household income was likely to continue against the background that firms continued to feel a shortage of labor and corporate profits were expected to remain generally high. Some members said that the year-on-year rate of change in regular payments had been positive, as the effects of retirement of baby boomers had almost dissipated. One of these members added that a marked increase in wages nevertheless remained unlikely, since small and medium-sized firms were taking great care to prevent labor costs from increasing.

Members agreed that housing investment had remained at a low level, although there had been signs of recovery such as the improvement in the number of housing starts. They were of the opinion that housing investment was likely to be sluggish for the time being but recover gradually thereafter. Some members, however, said that, as there was some weakness in sales of housing, particularly condominiums, partly due to a rise in prices of building materials and sluggishness in the improvement in housing affordability, the future pace and extent of recovery in housing investment were uncertain.

Members agreed that production had been more or less flat lately, partly in reaction to the relatively large increase in the second half of 2007. Some members noted that this was due mainly to the fact that the high level of production of IT-related goods, which had continued since the completion of inventory adjustments, was coming to an end, as was the accelerated production of automobiles to make up for the disruption caused by the earthquake in Niigata Prefecture. A few members said that inventories had been more or less in balance with shipments, and it seemed that the upward trend in production was being basically maintained. One of these members added that exports were likely to

continue to increase, and this strongly supported the view that the upward trend in production would continue. One member expressed the opinion that a significant production adjustment was unlikely, judging from anecdotal information from firms. A different member commented that it was too early to conclude that the recent developments in production suggested a change in its trend, but careful attention should continue to be paid to the global economic slowdown and its effects on domestic production.

Members discussed the effects on Japan's overall economy of the deterioration in the terms of trade resulting from the rise in energy and materials prices. A few members said that, by depressing corporate profits and wages, it had reduced the economy's capacity to generate income. One of these members added that this was already evidenced in a lower growth rate of real gross domestic income. One member commented that, although deterioration in the terms of trade indeed caused an outflow of a country's income to overseas economies, it should also be noted that it generally led to an increase in its exports as well as a decrease in its imports, and in turn an increase in its real domestic output. A different member noted that at present there were some positive factors that could absorb the negative effect of the deterioration in the terms of trade: the high corporate profits of Japanese firms and an expected increase in demand for Japanese products, especially from oil-producing economies, reflecting the growing global economy. The member expressed the opinion that the impact on the overall economy depended ultimately on the extent to which these positive factors could absorb the negative effect of the deterioration in the terms of trade.

As for prices, members said that the three-month rate of change in the CGPI had been positive, mainly due to the rise in international commodity prices, and the CGPI was likely to continue increasing for the time being.

Members concurred that the year-on-year rate of change in the CPI (excluding fresh food) was likely to follow a positive trend due to the rise in prices of petroleum products and food products in the short run and the positive output gap in the longer run. One member said that the year-on-year rate of increase in the CPI (excluding fresh food) was likely to continue to rise for the time being. A different member was of the view that, although the appreciation of the yen would exert downward pressure on prices of imports, its effect on domestic prices would be limited, given that many firms had been unable to sufficiently pass on higher costs caused by the rise in prices of imported materials to sales

prices.

B. Financial Developments

On financial developments in Japan, members concurred that the financial environment remained accommodative. They also agreed that the issuing environment for CP and corporate bonds had been favorable as a whole, although issuance spreads on those issued by firms with low credit ratings had expanded slightly, and that the lending attitudes of financial institutions had continued to be accommodative. A few members commented that the effects of disruptions in global financial markets on the domestic financial environment remained limited so far, but attention should be paid to slight deterioration observed in credit conditions of small firms, financial institutions' lending attitudes with regard to provision of loans to small firms, and the issuing environment for corporate bonds with low credit ratings.

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

On the guideline for money market operations for the intermeeting period ahead, members agreed that, given the economic and financial situation, it would be appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0.5 percent. They shared the following view: (1) the virtuous circle of growth in production, income, and spending basically remained in place, and Japan's economy was likely to continue expanding moderately with price stability; (2) however, there remained considerable uncertainty regarding future developments in overseas economies, global financial markets, and international commodity prices; (3) the pace of growth of Japan's economy was slowing recently due to the effects of high energy and materials prices in addition to the drop in housing investment; and (4) in this situation, it was appropriate to carefully examine economic and financial developments at home and abroad to grasp the situation more accurately. A few members said that the Bank should continue to conduct money market operations flexibly and in a timely manner through the fiscal year-end, giving due consideration to the situation of financial markets and individual financial institutions, both at home and abroad.

Members concurred that their basic thinking on the monetary policy stance for the future remained unchanged. They agreed that, as risk factors had been increasing both at

home and abroad, the Bank should, in a forward-looking manner, assess the likelihood of the projected future paths of the economy and prices, as well as both upside and downside risks, and make policy decisions based on the assessment. One member said that the sustainability of the virtuous circle of growth in production, income, and spending should be closely examined, given that firms had recently become noticeably cautious. A different member assessed the outlook for economic activity and prices as well as risks from the "two perspectives," and expressed the following view: the scenario that Japan's economy would return to a path of moderate expansion after a slowdown in the short run remained unchanged; however, in addition to uncertainty regarding future developments in the U.S. economy and global financial markets, the possibility that high energy and materials prices might negatively affect small firms' performance and consumer sentiment in Japan, another risk factor, was becoming stronger. Based on this view, the member continued that, while maintaining the basic thinking regarding the conduct of monetary policy, the Bank should flexibly take the policy action that was considered most appropriate to the situation, based on a thorough assessment of the likelihood of the projected future paths of the economy and prices, as well as both upside and downside risks. Another member expressed the view that, although the current general direction of adjustment in the policy interest rate was considered to be appropriate, in the future if the situation called for an easing, the Bank should flexibly take an appropriate action.

IV. Remarks by Government Representatives

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

- (1) The government would like to acknowledge Governor Fukui and the two Deputy Governors, whose term of office would expire on March 19, 2008, for the efforts they had made since taking office in March 2003. They and the staff had been committed to sound economic development through the maintenance of price stability. The government would like to express its appreciation of their efforts over the past five years.
- (2) Japan's economic recovery had been at a more moderate pace recently, reflecting the fact that housing construction remained at a low level, albeit with some recovery, and corporate profits appeared to have stopped improving. Domestic corporate goods prices had been rising due to increased materials prices. The trend of consumer prices

had been only slightly upward although prices, particularly those of petroleum products, had been rising recently.

- (3) Given the current developments in economic activity and prices, the government would like the Bank to continue to support the economy from the financial side so as to ensure the sustainability of the ongoing economic recovery.
- (4) Developments in the U.S. subprime mortgage problem, in crude oil prices, and in the global economy, particularly the U.S. economy, should continue to be watched closely. On February 20, 2008, the government released "Measures for Small- and Medium-Sized Enterprises towards the End of the Fiscal Year." It included measures to address issues faced by small firms, which had been significantly affected by the surge in crude oil prices and the revision of the Building Standard Law. Particular attention should be paid to developments in small firms. The government would like the Bank to carefully monitor both the effects of developments in these areas on Japan's economy and developments in financial markets, and continue to react appropriately to changes in trends. The Ministry of Finance would also give due consideration to developments in the economy and financial markets, both at home and abroad.
- (5) Furthermore, the government would like the Bank to clearly explain to market participants and the public its view regarding the current situation and future course of Japan's economy and its thinking on the future conduct of monetary policy.

The representative from the Cabinet Office made the following remarks.

- (1) Japan's economic recovery had been at a more moderate pace recently, as the slowdown in export growth amid the continued sluggishness in private consumption and housing construction had been depressing the growth in production. In addition, there were overseas developments that could be risk factors to Japan's economy such as the slowdown in the U.S. economy and the swings in global financial markets, both of which had stemmed from the U.S. subprime mortgage problem. The weaknesses observed in the domestic economy and the overseas developments were increasing the downside risks to Japan's economy, and therefore future developments in Japan's economy warranted even more careful attention. The trend of consumer prices had been only slightly upward although prices, particularly those of petroleum products, had been rising. The year-on-year pace of decrease in unit labor costs and the GDP

deflator accelerated in the October-December quarter of 2007, suggesting that inflation pressures stemming from domestic factors remained weak. In view of the severe business environment surrounding small firms amid increasing downside risks to the economy, the government released "Measures for Small- and Medium-Sized Enterprises towards the End of the Fiscal Year." The government would continue to pay close attention to developments in crude oil prices, the U.S. economy, and foreign exchange rates.

- (2) In order to ensure sustainable economic growth led by private demand and achieve a stable inflation rate that would be compatible with that growth, it was important for the government and the Bank to implement their policies based on the shared basic perspective on macroeconomic management.
- (3) The government would like to request the Bank to implement effective monetary policy that was consistent with the government's policy efforts and outlook for the economy, and to firmly support the economy from the financial side, paying due attention to economic and price developments in view of 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 0.5 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).

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.

A. Mizuno, Mr. K. G. Nishimura, Mr. T. Noda, Mr. S. Nakamura, and Mr. H. Kamezaki.

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 March 7, 2008 and the whole report on March 10, 2008.⁶

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of February 14 and 15, 2008 for release on March 12, 2008.

⁶ The English version of the whole report was published on March 11, 2008.

Attachment

March 7, 2008

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. A. Mizuno, Mr. K. G. Nishimura, Mr. T. Noda, Mr. S. Nakamura, and Mr. H. Kamezaki.
Voting against the action: None.