Not to be released until 8:50 a.m. Japan Standard Time on Friday, September 10, 2010.

September 10, 2010

Bank of Japan

Minutes of the Monetary Policy Meeting

on August 9 and 10, 2010

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

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Monday, August 9, 2010, from 2:00 p.m. to 4:44 p.m., and on Tuesday, August 10, from 9:00 a.m. to 12:23 p.m.[1]

Policy Board Members Present

Mr. M. Shirakawa, Chairman, Governor of the Bank of Japan

Mr. H. Yamaguchi, Deputy Governor of the Bank of Japan

Mr. K. G. Nishimura, Deputy Governor of the Bank of Japan

Ms. M. Suda

Mr. T. Noda

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Government Representatives Present

Mr. M. Ikeda, Senior Vice Minister of Finance, Ministry of Finance[2]

Mr. Y. Kinoshita, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance[3]

Mr. H. Hiraoka, Senior Vice Minister for Economic and Fiscal Policy, Cabinet Office[2]

Mr. K. Umetani, Director-General, Economic and Fiscal Management, Cabinet Office[3]

Reporting Staff

Mr. K. Ido, Executive Director

Mr. K. Yamamoto, Executive Director

Mr. H. Nakaso, Executive Director (Assistant Governor)

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on September 6 and 7, 2010 as "a document describing an outline of the discussion at the meeting" stipulated in Article 20, paragraph 1 of the Bank of Japan Act of 1997. Those present are referred to by their titles at the time of the meeting.

[2] Messrs. M. Ikeda and H. Hiraoka were present on August 10.

[3] Messrs. Y. Kinoshita and K. Umetani were present on August 9.

Mr. M. Amamiya, Executive Director[4]

Mr. S. Kushida, Director-General, Monetary Affairs Department

Mr. T. Kato, Head of Policy Planning Division, Monetary Affairs Department[5]

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

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

Mr. T. Sekine, Head of Economic Research Division, Research and Statistics Department

Mr. H. Ono, Director-General, International Department

Secretariat of the Monetary Policy Meeting

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

Mr. T. Tachibana, Director, Deputy Head of Planning and Coordination Division, Secretariat of the Policy Board

Mr. A. Otani, Senior Economist, Monetary Affairs Department

Mr. H. Ichiue, Senior Economist, Monetary Affairs Department

[4] Mr. M. Amamiya was present on August 9 for the whole of the session, and on August 10 from 10:29 a.m. to 12:23 p.m.

[5] Mr. T. Kato was present on August 9 for the whole of the session, and on August 10 from 10:53 a.m. to 12:23 p.m.

I. Summary of Staff Reports on Economic and Financial Developments[6]

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 July 14 and 15, 2010.[7] The uncollateralized overnight call rate had been at around 0.1 percent.

The Bank continued its provision of funds through the fixed-rate funds-supplying operation against pooled collateral, and in consideration of the recent formation of market rates, conducted money market operations in a flexible manner.

B. Recent Developments in Financial Markets

Money market rates had generally been stable at low levels due in part to the Bank's provision of ample funds. General collateral (GC) repo rates had been in the range of 0.10-0.15 percent. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with a one-year maturity, had been stable in the range of 0.10-0.15 percent, and the TIBOR rates had generally been on a declining trend. Issuance rates on CP had remained more or less unchanged at low levels.

Japanese stock prices, after declining partly due to the appreciating trend of the yen, had recovered somewhat along with the recent rises in U.S. and European stock prices. The Nikkei 225 Stock Average had recently been at around 9,500 yen. Long-term interest rates in Japan had continued to decline, and the benchmark rate had recently been at around 1.0 percent.

The yen had appreciated against the U.S. dollar amid concern about deceleration in the U.S. economy, and had recently been in the range of 85-86 yen.

C. Overseas Economic and Financial Developments

The world economy had continued to recover moderately.

The U.S. economy was recovering at a moderate pace. Although the pace was decelerating partly due to slower growth in inventory investment, exports were continuing to increase and business fixed investment was rising moderately. In the labor market, the

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[6] Reports were made based on information available at the time of the meeting.

[7] The guideline was as follows:

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

unemployment rate had been more or less unchanged at a high level, and this suggested that the employment situation had not improved noticeably. In this situation, private consumption was increasing only gradually. Housing investment remained broadly unchanged at a depressed level, with some fluctuations. As for prices, the year-on-year rate of increase in the consumer price index (CPI) for all items less energy and food, or the core CPI, had been moderating partly due to slack in supply and demand conditions.

Economic activity in the euro area was picking up, with some differences in growth by country. Domestic demand components such as private consumption had been relatively weak as a whole, but exports had been firm partly due to the depreciation of the euro, and production had been increasing gradually. As for prices, the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) excluding energy and unprocessed food had been declining moderately partly due to slack in supply and demand conditions. U.K. economic conditions were recovering at a moderate pace.

The Chinese economy had continued to grow at a relatively rapid pace. Exports had been rising due to the recovery in overseas economies, and growth in private consumption had been firm; fixed asset investment had been increasing in this situation, although at a slower pace. Reflecting these developments in demand, production had been on an upward trend, but its growth was decelerating mainly due to the effects of measures to restrain the increase in real estate transactions. Economic conditions in the NIEs and the ASEAN countries were recovering steadily. Exports had continued to rise on the back of expanding demand for IT-related goods, and private consumption and business fixed investment had been on an increasing trend. Under these circumstances, production had continued to increase. The Indian economy had also continued to grow at a relatively rapid pace. In many of these Asian economies, upward pressure on prices had been increasing due to higher energy and food prices and greater utilization of production factors such as labor and capital.

As for global financial markets, although sovereign risks in some European countries had continued to be a concern, the fact that European financial institutions had completed the stress test exercise without any major disruption had somewhat eased strains in the interbank market. U.S. and European stock prices had risen slightly despite some worse-than-expected U.S. economic indicators, as most corporate results had come in better than expected and the uncertainty about the European financial system had lessened following publication of the stress test exercise results. Long-term interest rates in the United States had declined partly because some indicators showed signs of economic deceleration. Those in Germany had been more or less unchanged, although there was a swing back from a flight to quality. Those in some other European countries had declined somewhat, but remained at high levels on the back of concern about their sovereign risks.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports had been increasing, due to the improvement in overseas economic conditions. The uptrend in exports was expected to continue, reflecting continued improvement in overseas economic conditions, although the pace of increase was likely to moderate.

Public investment was declining, and this trend was likely to continue.

With regard to domestic private demand, business fixed investment was showing signs of picking up. Although such signs were expected to gradually become evident with the continued improvement in corporate profits, the pace of improvement in business fixed investment was likely to remain moderate for the time being amid the persistent sense among firms of excessive capital stock.

Private consumption had been generally picking up. Meanwhile, the employment and income situation had remained severe, but the degree of severity had eased somewhat. Private consumption was expected to continue picking up, but the pace of improvement was likely to remain moderate for the time being, since the effects of policy measures were expected to wane.

Housing investment had leveled out. It was expected to gradually head for a recovery, given the recent developments in housing starts.

Production had been increasing. It was likely to continue rising as a trend in parallel with exports, although the pace of increase was expected to moderate.

On the price front, commodity prices, which started decreasing in May, leveled out and were recently more or less flat. The three-month rate of increase in the domestic corporate goods price index (CGPI) was slowing, mainly due to the earlier decrease in commodity prices, amid the persistent slack in supply and demand conditions for products. The CGPI was expected to be somewhat weak for the time being, since the effects of the decrease in commodity prices were likely to continue. The CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline had continued. The year-on-year pace of decline in the CPI was likely to slow as a trend as the aggregate supply and demand balance improved gradually.

2. Financial environment

Financial conditions had continued to show signs of easing. The overnight call rate had remained at an extremely low level, and the declining trend in firms' funding costs had continued. While stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices, such effects were beginning to strengthen in light of improved corporate profits. With regard to credit supply, firms saw financial institutions' lending attitudes as improving. Issuing conditions for CP and corporate bonds had remained favorable. As for credit demand, firms' need to fund working capital and fixed investment had declined, and some firms had reduced the on-hand liquidity that they had accumulated. Against this backdrop, bank lending had declined on a year-on-year basis. The amount outstanding of corporate bonds had exceeded the previous year's level, while that of CP had declined. In these circumstances, firms' financial positions had continued to show signs of improvement as a whole. Meanwhile, the year-on-year rate of change in the money stock had been in the range of 2.5-3.0 percent.

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

A. Economic Developments

Members said that market participants had generally reacted positively to the results of the stress test exercise conducted on European financial institutions, and global financial markets had consequently regained some stability. Some members expressed the following view: there was some criticism that the stress scenario used for the exercise was not strenuous enough; however, disclosure of individual financial institutions' exposures to European sovereign debt had enabled investors to conduct their own stress test exercise on specific financial institutions, using original scenarios they deemed appropriate, and this had enhanced the transparency of the European banking sector and thus induced the market's positive reaction. However, most members expressed the view that completion of the stress test exercise did not mean that sovereign risks in some European countries had been eliminated, and it would take time for the problem to be resolved fundamentally.

Members shared the view that overseas economies had continued to recover moderately, and this trend was likely to continue led by high growth in emerging economies. Many members expressed the opinion that advanced economies were likely to continue recovering, but the pace would probably remain moderate amid the lingering severity in balance-sheet adjustments. Many members noted that the pace of recovery in emerging economies, which had previously been rapid, was somewhat slowing mainly reflecting tighter policies, and said that the slowdown should be considered as a shift toward a more sustainable and steady pace, although future developments still required close monitoring. One member said that attention should be paid to the recent emergence of signs of a downward shift in trends in overseas economies, which was observed in line with changes in market views.

Members shared the view that the U.S. economy as a whole was recovering at a moderate pace. Some members said that the current situation in the U.S. economy, which was facing severe balance-sheet adjustments, was broadly in line with their highly cautious assessment, which had been made based on Japan's post-bubble experience. However, many members, including these members, said that attention should be paid to the fact that (1) some U.S. economic data pointed to a slower economic recovery and (2) uncertainty about the outlook for the U.S. economy was arising in the market. Turning to developments in each demand component, a few members expressed the opinion that the restocking of inventories, which had previously been reduced substantially following the Lehman shock, was coming to an end. Many members said that private consumption was increasing only gradually amid the continuing severe employment situation. On the other hand, some members said that business fixed investment was rising on the back of high corporate profits. Members shared the view that the U.S. economy as a whole was likely to continue recovering, but the pace would probably remain moderate.

Many members expressed the view that economic activity in the euro area overall was picking up, with some differences in growth by country. Many members said that exports had been increasing steadily on the back of the depreciation of the euro. One member said that recently released economic indicators were relatively firm despite the financial market turmoil that had continued since spring 2010. Some members were of the view that the euro area economy would likely recover only moderately, because economic activity would be constrained by balance-sheet adjustments and moves toward fiscal consolidation.

Members agreed that the Chinese economy had continued to grow at a rapid pace, although the rate was slowing somewhat mainly due to the effects of measures to restrain the increase in real estate transactions. A few members noted that the economy had continued to exhibit double-digit real growth on a year-on-year basis, although it had decelerated slightly. Many members said that the pace of economic growth was likely to slow somewhat further, mainly due to the effects of measures to restrain the increase in real estate transactions. They saw these developments as favorable from a long-term perspective because such measures would reduce the risk of overheating and thus lead to more sustainable economic growth. In this regard, some members said that the Chinese economy might temporarily experience a significant slowdown if the effects from such measures were too strong. A different member argued that it was unlikely to decelerate rapidly in the near future, taking account of a wide range of policy tools the Chinese authorities could use.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy. They concurred that the economy showed further signs of a moderate recovery, induced by improvement in overseas economic conditions. As for the outlook, they agreed that the economy was likely to be on a moderate recovery trend. Some members expressed the view that the economy would inevitably slow because it continued to exhibit high growth in the process of recovering from the Lehman shock. Some members said that Japan's economy was likely to remain on a recovery trend, but the pace of recovery might temporarily slow due to a waning of policy effects in the latter half of fiscal 2010. One member, however, added that a slowdown in the pace of recovery was already incorporated to some extent in the member's interim assessment at the previous meeting.

With regard to risks for economic activity, some members expressed the opinion that risk factors had not changed significantly from the interim assessment. As upside risk factors, many members again cited even faster growth in emerging and commodity-exporting economies. Some of these members said that the pace of growth in these economies might accelerate further if a shift in macroeconomic policy lagged behind or capital flows from advanced economies to these economies increased. One member was of the view that tighter monetary policy conducted by a number of emerging and commodity-exporting economies might not produce the intended effects for some time, because it might increase capital flows from advanced economies that maintained accommodative monetary policy. As downside risk factors, on the other hand, members shared the view that factors such as developments concerning sovereign risks in some European economies and the emergence of market uncertainty over the U.S. economy could adversely affect domestic and overseas economies through developments in global financial markets, particularly foreign exchange markets. In relation to the effects that sovereign risks in Europe might produce, a few members were of the view that the uncertainty about the European financial system had lessened somewhat following publication of the stress test exercise results, but fiscal problems still existed. As for risks to the U.S. economy, a few members pointed to some indicators of a slower recovery and expressed their increased awareness of downside risks. One of these members noted the possibility that the decline in U.S. long-term interest rates reflected a decrease in the expected economic growth rate. However, a few other members expressed the view that the considerable retroactive upward revision in the personal saving rate might suggest that balance-sheet adjustments in the household sector had progressed faster than expected, and this might have somewhat reduced concerns about the sustainability of the recovery in U.S. private consumption. Meanwhile, one member said that the recent slight slowdown in emerging economies could be viewed as a downside risk factor in the short run but lead to a more sustainable expansion of these economies in the long run. This member underscored the importance of discussing risk factors from various perspectives, such as different timeframes.

Turning to developments in each demand component, members shared the view that exports had been increasing, mainly due to high growth in emerging economies and the expansion in global demand for IT-related goods. However, many members said that the pace of increase in exports had at last started to decelerate in line with expectations as exports to China, which had accelerated until recently, were slowing. Many members agreed that the uptrend in exports was likely to continue, reflecting continued improvement in overseas economic conditions, although the pace of increase was likely to moderate.

Members agreed that business fixed investment was showing signs of picking up. Many members expressed the view that signs of a pick-up were likely to gradually become evident with the continued improvement in corporate profits. Many members noted that a survey conducted by the Development Bank of Japan showed that the aggregated amount of all industries' business fixed investment plans for fiscal 2010 had exceeded the previous year's actual level for the first time in three years, as in the June 2010 *Tankan* (Short-Term Economic Survey of Enterprises in Japan). Some members observed that Japanese firms were rapidly increasing fixed investment overseas, and pointed to the need for close monitoring of whether this exerted downward pressure on domestic fixed investment.

Members shared the view that the employment and income situation had remained severe but the degree of severity had eased somewhat. A few members noted that summer bonus payments had stopped decreasing. One member, on the other hand, expressed the view that firms remained cautious about the outlook and would basically maintain their stance of restraining labor costs amid the persistent sense of an excessive workforce.

Members agreed that private consumption had been generally picking up. A few members said that private consumption, which seemed to have been lackluster in the April-June quarter, was likely to receive a boost from the extremely hot weather. Some members expressed the opinion that the pace of improvement in private consumption was likely to be only moderate for the time being mainly due to the waning effects of the policy measures. Many members said that car sales were likely to decrease following a last-minute increase ahead of the termination of the subsidies for purchasers of environmentally friendly cars scheduled for the end of September. One of these members expressed the opinion that some areas of consumption, such as services consumption, might have been restrained for the sake of purchases of durable goods that had been directly supported by policy measures. This member continued that private consumption in such areas might recover following the termination of the policy measures, and pointed to the need to take into account such a recovery in examining the degree of consequent changes in overall consumption.

Members agreed that production had been increasing, mainly reflecting high growth in emerging economies and the expansion in global demand for IT-related goods. Some members said that it was difficult to accurately grasp the actual trend of production due to a distortion in seasonal adjustments caused by the significant drop following the

Lehman shock, but information obtained, for example, from interviews with corporate managers indicated a continuing, albeit slower, increase in production. A few members said that the risk of sudden deterioration in the global supply and demand balance for IT-related goods required attention. Some members expressed the view that the pace of increase in production would moderate since the effects of policy measures and inventory restocking would wane and the growth rates of emerging economies, including the Chinese economy, were slowing to a more sustainable pace. However, these members were of the view that production was likely to continue rising as a trend, reflecting the ongoing recovery in overseas economies.

Members concurred that the CPI (excluding fresh food) was declining on a year-on-year basis due to the substantial slack in the economy as a whole, but excluding the effects of subsidies for high school tuition, the slowing trend in the pace of decline had continued. One member said that, in the June CPI data, the figure representing the difference between the number of items for which prices had declined and of items for which prices had risen was smaller than that of the previous month, and this might suggest that the spread of price declines to a wider range of goods and services had come to a halt. As for the outlook, members agreed that the year-on-year pace of decline in the CPI was likely to slow as the aggregate supply and demand balance improved gradually. One member said that the negative output gap had narrowed significantly amid the sharp recovery in GDP growth in the latter half of fiscal 2009 and, with some time lag, this would ease deflationary pressure in the latter half of fiscal 2010. Some members referred to developments in import prices as a risk factor for prices, and pointed to the need to closely monitor (1) how developments in overseas economies, particularly emerging economies, would affect commodity prices and eventually prices in Japan and (2) the effects of changes in foreign exchange rates. One member said that inflation expectations might decline since deflationary concerns were becoming a topic of discussion globally.

B. Financial Developments

Members shared the view that financial conditions had continued to show signs of easing.

Some members said that Japan's money market had been stable due in part to the Bank's provision of ample funds. One member commented that the recent decline in long-term interest rates had led to a fall in firms' funding costs. A different member expressed the view that stimulative effects from low interest rates had strengthened further amid the recovery in corporate profits.

Some members compared the recent decline in long-term interest rates with the previous fall to below 1 percent, observed in 2002 and 2003, particularly in terms of changes in financial institutions' behavior. These members pointed to the fact that, compared with that time, financial institutions' profits and capital bases had improved and their risk management had become more sophisticated. As regards future developments in long-term interest rates, members said that developments in financial institutions' securities investment continued to require close and unbiased monitoring.

Members agreed that issuing conditions for CP and corporate bonds were favorable, even those for low-rated bonds, in which improvement had lagged behind. Some members said that spreads on BBB-rated bonds in the secondary market had narrowed. A few members pointed to the recent bond issuance by firms that had previously deferred issuance in view of the instability in global financial markets stemming from the heightened sovereign risks in Europe, and also noted the increase in the number of firms issuing bonds.

Members concurred that financial institutions' lending attitudes, as perceived by firms, and firms' financial positions had continued to show signs of improvement. A few members said that lending standards had been eased in a situation where the amount outstanding of bank loans had remained lower than the previous year due to weak corporate demand for funds. Many members commented that recently released survey results suggested that a wide range of firms including very small ones judged their financial positions to have improved.

With regard to recent developments in foreign exchange markets, many members raised the possibility that the appreciation of the yen might depress growth in exports and corporate profits. Many members commented that attention should be paid to how the appreciation and a consequent weakness in stock prices affected business and consumer confidence. One member expressed the view that the risk of the yen's value remaining at the recent level had increased. Some members said that the appreciation of the yen might accelerate firms' shifting of production sites abroad. One member expressed the opinion that the main contributing factor to the recent shift was not the yen's appreciation but emerging economies' high growth. The member added that the yen's appreciation also had an advantage of reducing firms' spending associated with purchases of imported materials and acquisition of foreign firms. A few members said that how significantly the yen's appreciation affected Japan's economic activity depended on various factors such as developments in the world economy, corporate profits, and financial conditions, and that the Bank should therefore assess the effects by considering these factors comprehensively in a well-balanced manner. One of these members said that the recent value of the yen against the U.S. dollar was at around the level observed immediately after Dubai's debt crisis in November 2009, but compared with that time financial conditions had become more accommodative and corporate profits had improved. A different member commented that the nominal value of the yen against the dollar was approaching its peak recorded in 1995 and this was a topic of discussion, but the yen's real effective exchange rate was not as high as that in 1995 because Japan's inflation rate since then had been low. The member continued that the effects on Japan's economic activity of the appreciation of the yen and the fall in prices should not be assessed separately but comprehensively. Based on this discussion, members agreed that developments in foreign exchange markets and the effects on Japan's economic activity continued to warrant close attention.

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

Regarding <u>the guideline for money market operations for the intermeeting period ahead</u>, members agreed that, given the above assessment of economic activity and prices, it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

As for <u>the future conduct of monetary policy</u>, members agreed that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank should continue to consistently make contributions as central bank. They concurred that, in the conduct of monetary policy, the Bank would continue to aim at maintaining the extremely accommodative financial environment.

Members discussed <u>the fund-provisioning measure to support strengthening the foundations for economic growth</u>, the introduction of which the Bank decided in June. Many members were very encouraged by the fact that individual financial institutions were taking the initiative to actively formulate business plans toward strengthening the foundations for economic growth, taking into account the characteristics of, for example, their customer base and the regions they served. A few of these members said that many regional financial institutions had qualified for the measure and their involvement was expected to help boost local economic activity. Many members expressed the view that, partly due to the introduction of the measure, the public had become increasingly aware that the most critical challenge the Japanese economy was facing was to raise the potential economic growth rate and productivity, and that the Bank needed to continue to explain clearly the importance of raising productivity.

IV. Remarks by Government Representatives

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

(1) The Japanese economy had been picking up steadily, and the foundation for a self-sustaining recovery was being laid. Nevertheless, the situation remained difficult, as evidenced by the high unemployment rate. As for short-term prospects, in addition to risk factors such as a possible slowdown in overseas economies, especially the U.S. and European economies, international financial developments, and deflation, there was continued concern that the employment situation could deteriorate further, and therefore the basis for the economy's return to a path of strong private demand-led growth remained fragile.

(2) In the "New Growth Strategy," the government stated that it regarded overcoming deflation as the top-priority task in its macroeconomic policy management; in overcoming deflation, it aimed to make the CPI inflation rate positive by the end of fiscal 2011, and quickly achieve and maintain a positive inflation rate. The government, by continuing to put forward the measures specified in the strategy, would endeavor to eliminate the negative output gap, placing priority on the implementation of measures and programs that were highly effective in creating demand and jobs.

(3) In the "Budgetary Request Guidelines for Fiscal 2011," which had recently been decided by the Cabinet, the government stated that it would allocate the budget within the limit of approximately 71 trillion yen, prioritizing strategic measures such as those specified in the "New Growth Strategy" and those that would contribute to the stability and security of people's lives.

(4) The Bank recognized, as did the government, that the critical challenge for Japan's economy was to overcome deflation, and presented its view that it would maintain the extremely accommodative financial environment. The government expected that the Bank -- bearing in mind that the policy objective was shared by both entities -- would continue to support the economy from the financial side, for example, with a view to overcoming deflation, by conducting monetary policy in an appropriate and flexible manner while closely exchanging views with the government.

The representative from the Cabinet Office made the following remarks.

(1) In the government's opinion, the Japanese economy had been picking up steadily and the foundation for a self-sustaining recovery was being laid. Nevertheless, the situation remained difficult, as evidenced by the high unemployment rate. Moreover, there was uncertainty about the outlook for the world economy, especially the U.S. and European economies, and there also was a risk of financial markets becoming volatile. Attention should therefore be paid to the effects of these factors on the Japanese economy. As for prices, the year-on-year rate of change in the CPI for June was minus 1.0 percent, which included the effects of subsidies for high school tuition of about minus 0.5 percentage point, marking the 16th consecutive month of negative figures. In the midyear economic projection for fiscal 2010 by the Cabinet Office, the government forecasted that deflation would continue.

(2) Based on the "New Growth Strategy," the government -- viewing recovery in demand, which was constrained under deflation, as a pressing challenge -- would make policy efforts to eliminate the negative output gap. With regard to the formulation of the budget for fiscal 2011, the Cabinet decided in July the "Budgetary Request Guidelines for Fiscal 2011," which placed emphasis on overcoming deflation and increasing employment. The government regarded overcoming deflation as the top-priority task in its macroeconomic policy management, and thus aimed to make the CPI inflation rate positive by the end of fiscal 2011 and to quickly achieve and maintain a positive inflation rate.

(3) The rates of inflation projected in the Bank's April 2010 *Outlook for Economic Activity and Prices* had still been below the figures representing the Policy Board members' "understanding of medium- to long-term price stability." The government, while

recognizing that the Bank had been proceeding with the measure to support strengthening the foundations for economic growth, expected it to remain well aware that overcoming deflation was a policy objective that both entities shared, and to conduct monetary policy in an appropriate and flexible manner while sufficiently exchanging views and working together with the government.

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 0.1 percent.

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

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.

   The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.1 percent.

2. A public statement will be decided separately.

Votes for the proposal: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Ms. M. Suda, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, and Mr. Y. Morimoto.

Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

Members discussed the Statement on Monetary Policy, and put it to a vote. The Policy Board decided the text by a unanimous vote. It was confirmed that the statement would be released immediately after the meeting (see Attachment).

VII. Approval of the Minutes of the Monetary Policy Meeting

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of July 14 and 15, 2010 for release on August 13, 2010.

Attachment

August 10, 2010

Bank of Japan

Statement on Monetary Policy

1. At the Monetary Policy Meeting held today, the Policy Board of the Bank of Japan decided, by a unanimous vote,[8] 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 0.1 percent.

2. Japan's economy shows further signs of a moderate recovery, induced by improvement in overseas economic conditions. Exports and production have been increasing mainly due to high growth in emerging economies and increased global demand for IT-related goods. Business fixed investment is showing signs of picking up. The employment and income situation has remained severe, but the degree of severity has eased somewhat. In these circumstances, private consumption has been generally picking up. Public investment is declining. Meanwhile, financial conditions have continued to show signs of easing. The CPI (excluding fresh food) is declining on a year-on-year basis due to the substantial slack in the economy as a whole, but the slowing trend in the pace of decline has continued.

3. The Bank's baseline scenario projects that the economy is likely to be on a recovery trend. With regard to prices, based on the assumption that medium- to long-term

[8] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Ms. M. Suda, Mr. T. Noda, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, and Mr. Y. Morimoto.
Voting against the action: None.

inflation expectations remain stable, the year-on-year rate of decline in the CPI (excluding fresh food) is expected to slow as the aggregate supply and demand balance improves gradually.

4. With regard to economic activity, there are some upside risks such as even faster growth in emerging and commodity-exporting economies. On the other hand, there are also downside risks such as those related to international financial developments. In this regard, attention should be paid to the effects of, for example, developments in fiscal and financial conditions in some European economies on domestic and overseas economies through developments in global financial markets. With regard to prices, there is a possibility that inflation will rise more than expected due to a rise in commodity prices brought about by higher growth rates in emerging and commodity-exporting economies, while there is also a risk that the rate of inflation might decline due, for example, to a decline in medium- to long-term inflation expectations.

5. The Bank recognizes that Japan's economy faces the critical challenge of overcoming deflation and returning to a sustainable growth path with price stability. To this end, the Bank will continue to consistently make contributions as central bank. In the conduct of monetary policy, the Bank will aim to maintain the extremely accommodative financial environment.