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February 17, 2012

Bank of Japan

Minutes of the Monetary Policy Meeting

on January 23 and 24, 2012

(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, January 23, 2012, from 2:00 p.m. to 4:14 p.m., and on Tuesday, January 24, from 9:00 a.m. to 12:26 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

Mr. S. Nakamura

Mr. H. Kamezaki

Mr. R. Miyao

Mr. Y. Morimoto

Ms. S. Shirai

Mr. K. Ishida

Government Representatives Present

Mr. Y. Fujita, Senior Vice Minister of Finance, Ministry of Finance[2]

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

Mr. H. Ogushi, Parliamentary Secretary of Cabinet Office, Cabinet Office[2]

Mr. K. Matsuyama, Vice Minister for Policy Coordination, Cabinet Office[3]

Reporting Staff

Mr. K. Yamamoto, Executive Director

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

Mr. M. Amamiya, Executive Director

Mr. N. Kinoshita, Executive Director

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[1] The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on February 13 and 14, 2012 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. Y. Fujita and H. Ogushi were present on January 24.

[3] Messrs. S. Sato and K. Matsuyama were present on January 23.

Mr. K. Momma, Director-General, Monetary Affairs Department

Mr. K. Kamiyama, Head of Policy Planning Division, Monetary Affairs Department

Mr. S. Aoki, Director-General, Financial Markets Department

Mr. E. Maeda, 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. M. Minegishi, Senior Economist, Monetary Affairs Department

Mr. T. Kawamoto, Senior Economist, Monetary Affairs Department

I. Summary of Staff Reports on Economic and Financial Developments[4]

A. Money Market Operations in the Intermeeting Period

The Bank, in accordance with the guideline decided at the previous meeting on December 20 and 21, 2011, had been providing ample funds sufficient to meet demand in financial markets and was doing its utmost to ensure stability in the markets.[5] In this situation, the uncollateralized overnight call rate had been in the range of 0.070 to 0.090 percent.

B. Recent Developments in Financial Markets

In the money market, interest rates had been stable as the sense of an abundance of liquidity continued to be strong amid the Bank's provision of ample funds. General collateral (GC) repo rates had been at around 0.1 percent on the whole. As for interest rates on term instruments, yields on treasury discount bills (T-Bills), including those with longer maturities, had been stable at around 0.1 percent. Rates on longer-term interbank instruments had been more or less unchanged.

With regard to U.S. dollar funding conditions, the U.S. dollar funding premium in the foreign exchange swap markets -- that is, the spread between the FX swap-implied U.S. dollar rate and U.S. dollar LIBOR -- had clearly declined after the turn of the year. This was mainly because financial institutions' need for U.S. dollar funds was gradually being fulfilled through active bidding for the U.S. dollar funds-supplying operations, and because concerns over funding conditions for European financial institutions for the time being had receded against a backdrop of the conduct of the 36-month longer-term refinancing operations with full allotment by the European Central Bank (ECB).

The benchmark long-term interest rate had been more or less flat at a low level on the back of solid demand from banks in particular, and had recently been at around 0.95 percent. Japanese stock prices had been steady in tandem with firm U.S. stock prices, and the Nikkei 225 Stock Average was recently in the range of 8,500-9,000 yen. In the foreign exchange market, the yen continued to move within a narrow range of around 76-78 yen against the U.S. dollar. The euro had been weakening against a wide range of currencies,

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[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 to 0.1 percent.

as interest rates in the euro area were on a declining trend reflecting monetary easing by the ECB. The yen temporarily appreciated to a level just below 98 yen against the euro.

C. Overseas Economic and Financial Developments

The pace of recovery of the world economy was slowing.

The U.S. economy continued to recover, but the pace of recovery remained moderate. Strains from balance-sheet adjustments continued to weigh on the economy despite some firmness observed recently. Under these circumstances, private consumption was increasing, but the pace of recovery generally remained only moderate. Housing investment remained at a depressed level with housing prices exhibiting weakness. On the other hand, exports and business fixed investment rose moderately. In this situation, production stayed on an increasing trend. As for prices, while slack in supply and demand conditions in the goods and labor markets continued to exert downward pressure on prices, the year-on-year rate of increase in the consumer price index (CPI) for all items decelerated to some extent due to an earlier fall in energy prices. Meanwhile, the year-on-year rate of increase in the CPI for all items less food and energy, or the core CPI, accelerated to some extent because the shelter index continued to rise moderately.

Economic activity in the euro area was increasingly sluggish. Growth in exports was sluggish owing to the slowdown in the world economy, and the rate of increase in business fixed investment had slowed. Private consumption was more or less unchanged. Household and business sentiment remained weak due to the worsening of the sovereign debt problems in Europe. Under these circumstances, production was declining. As for prices, although the year-on-year rate of increase in the Harmonized Index of Consumer Prices (HICP) for all items remained at a relatively high level, it had declined somewhat due to the effects of an earlier fall in international commodity prices. Meanwhile, the level of economic activity in the United Kingdom was more or less unchanged.

With regard to Asia, the Chinese economy continued to show high growth as a whole. The rate of increase in exports was slowing and that in production was decelerating to some extent; however, private consumption and fixed asset investment maintained high growth. The growth rate of the Indian economy had decelerated due to the cumulative effects of monetary tightening. The pace of economic growth in the NIEs and the ASEAN countries was slowing to some extent. Domestic demand -- private consumption in particular -- remained firm, but exports and production declined due to the slowdown in advanced economies, and also to the effects of the flooding in Thailand. In many of these Asian economies, core inflation rates were still at relatively high levels, mainly reflecting the higher wage inflation caused by tight labor market conditions. On the other hand, inflation rates for all items were declining at a moderate pace due mainly to a halt in the surge in prices of fresh food.

Global financial markets remained under heavy strain as the sovereign debt problems in Europe continued to be a matter of concern, reflecting difficulties with the negotiations to reduce the Greek government's debts, although there appeared to be signs of some improvement, as seen in the decline of short-term U.S. dollar funding rates in the money markets. In this situation, long-term interest rates in the United States were more or less flat at low levels, and those in Germany were declining moderately. The yield spreads of government bonds issued by European countries over German government bonds had widened and then tightened, and some of them had recently widened again, particularly for Portugal. With regard to the credit markets in Europe and the United States, yield spreads between corporate bonds and government bonds were more or less unchanged, at a relatively high level. As for the funding conditions of European financial institutions, spreads between interest rates on euro-denominated term instruments and overnight index swap (OIS) rates were declining somewhat, albeit with fluctuations, as provision of a large amount of funds by the ECB -- including its longer-term refinancing operations with a maturity of 36 months -- had brought about a positive effect in terms of diminishing European financial institutions' funding concerns. Meanwhile, U.S. stock prices had risen, and European stock prices followed suit. As for financial markets in emerging economies, many of these had recently seen a rise in their stock prices and some appreciation in their currencies.

D. Economic and Financial Developments in Japan

1. Economic developments

Exports and production remained more or less flat, due to the slowdown in overseas economies and the yen's appreciation as well as the remaining effects of the flooding in Thailand. They were expected to stay this course for the time being and increase moderately thereafter, mainly reflecting a pick-up in the pace of recovery in overseas economies.

Public investment had stopped declining. It was expected to increase gradually, mainly due to the restoration of damaged social capital.

Business fixed investment had been on a moderate increasing trend, aided partly by the restoration of disaster-stricken facilities. It was expected to continue a moderate increasing trend, partly due to efforts by firms to restore and reconstruct disaster-stricken facilities as well as to strengthen earthquake resistance and business continuity systems, although it would be affected by the slowdown in overseas economies for the time being.

The employment and income situation continued to be severe, although there were signs of improvement.

Private consumption remained firm, and this situation was expected to continue as the employment situation gradually headed toward improvement.

Housing investment had generally been picking up. It was expected to increase gradually, mainly due to the reconstruction of disaster-stricken homes.

As for prices, international commodity prices had been more or less flat recently, after having trended downward from the peak around spring 2011. The three-month rate of change in the domestic corporate goods price index (CGPI) showed some weakness, mainly due to the earlier decline in international commodity prices. The CGPI was expected to be more or less flat for the time being, reflecting movements in international commodity prices. The year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and was expected to stay at this level for the time being.

2. Financial environment

Financial conditions continued to ease.

The overnight call rate remained at an extremely low level, and firms' funding costs declined moderately. Stimulative effects from low interest rates were still partly constrained given current developments in economic activity and prices. With regard to credit supply, firms continued to see financial institutions' lending attitudes as being on an improving trend. Issuing conditions for CP continued to be favorable. Those for corporate bonds also remained favorable on the whole. As for credit demand, firms showed signs of increasing their demand mainly for working capital and funds related to mergers and acquisitions. Against this backdrop, the year-on-year rate of change in bank lending had been slightly positive. The amount outstanding of corporate bonds had been around its year-ago level, while that of CP continued to exceed its previous year's level. In these circumstances, firms retained their recovered financial positions on the whole. Meanwhile, the year-on-year rate of change in the money stock had been at around 3 percent.

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

A. Economic Developments

Members shared the view that global financial markets as a whole remained under heavy strain as the sovereign debt problems in Europe continued to be a matter of concern, although there appeared to be signs of some improvement in the money markets due to the provision of a large amount of funds by the ECB and the coordinated action with regard to U.S. dollar fund-provisioning by six central banks -- namely, the Bank of Canada, the Bank of England, the ECB, the Federal Reserve, the Swiss National Bank, and the Bank of Japan. Many members expressed the view that government bond yields in Portugal were rising while those in Spain and Italy remained at high levels, although yields were declining, particularly in the short- to medium-term zone, reflecting sufficient bidding in government bond auctions since the beginning of 2012. As background to persistent concerns about the sovereign debt problems in Europe, many members pointed to the following: (1) it was deemed that some more time would be needed for countries with fiscal concerns to make progress toward fiscal consolidation; (2) the burden on private creditors was increasing with regard to the Greek debt problem; and (3) a concrete proposal regarding expansion of the funding resources of the European Financial Stability Facility (EFSF) had not been finalized. Some members said that provision of liquidity by the ECB and by the six central banks were policies to buy time, and it was therefore necessary to work toward resolving the solvency problem in the meantime.

As for the outlook, members shared the view that financial markets were likely to remain under strain for the time being. Many members noted that particular attention should be paid to the possibility that strains in the markets could intensify over the spring, when the amounts of refinancing of government bonds issued by countries with fiscal concerns and of corporate bonds issued by European financial institutions were expected to become large. Many members expressed concern over a possibility that European financial institutions might accelerate the pace of reducing their assets as they were required to attain a capital ratio of 9 percent by the end of June 2012. In addition, one member said that it was becoming difficult for Greece to make progress toward fiscal consolidation, as negative economic growth continued. This member continued that, should the efforts toward fiscal consolidation turn out to be unsuccessful, there was a risk that the support framework for Greece by the European Union (EU) and the International Monetary Fund (IMF) would fall apart.

With regard to overseas economies, members concurred that the pace of growth had slowed mainly due to disturbances in global financial markets, on the back of the sovereign debt problems in Europe, and to the cumulative effects of monetary tightening in emerging economies. As for the outlook, they shared the view that the pace of growth was likely to continue to slow for the time being, particularly in the euro area economy, but would probably increase gradually thereafter led by emerging and commodity-exporting economies.

Members agreed that economic activity in the euro area on the whole was increasingly sluggish, including in Germany, where the economy had been firm. As background to the fact that even Germany's economic activity exhibited signs of sluggishness, many members pointed out that the effects of the sovereign debt problems in Europe were spreading through a deterioration in business and household sentiment as well as a more cautious lending stance by financial institutions. One member, however, added that there was still some firmness in the German economy relative to other European economies, as evidenced by the continued improving trend in the employment situation. As for the outlook, members shared the view that economic activity in the euro area would continue to be quite sluggish for the time being against the background of continuing fiscal austerity and European financial institutions' reduction of their assets. On this basis, they also shared the view that, depending on developments in the sovereign debt problems in Europe, economic activity in Europe could turn out to be significantly weaker than expected, via instability in the financial system in particular. They continued that it was therefore necessary to continue to pay due attention to future developments because a further economic downturn in Europe could trigger a global economic downturn.

Members shared the view that the U.S. economy continued to recover, but the pace of recovery remained moderate. They then made various comments on the firmness in the economy observed recently. Some members said that pessimistic views regarding the economy had subsided as business fixed investment was still rising against the background of favorable corporate profits, and as private consumption was firm reflecting the moderate improvement in the employment situation. One of these members added that the year-on-year rate of change in bank lending had been positive not only in commercial and industrial loans but also in consumer loans, and such developments were consistent with the recent firm movements in the economic indicators. In response, some members noted that strains from balance-sheet adjustments continued to weigh on the economy despite some firmness observed recently, and the pace of increase in private consumption and housing investment continued to be only moderate. One of these members commented that careful attention should be paid to the fact that the recent firmness in economic indicators was partly the result of an artificial spike from a distortion in seasonal adjustments and special factors stemming from the warm winter. One member pointed to the following four factors as background to the favorable business performance and subsequent rise in U.S. stock prices: (1) progress in cost cuts; (2) the high growth of businesses in emerging economies; (3) improvement in the profitability of exports reflecting the earlier depreciation of the U.S. dollar; and (4) a pick-up in financial institutions' profits due to a decline in interest rates. This member expressed the opinion that the sustainability of such developments largely depended on the second factor -- that is, the high growth in emerging economies.

In view of the above discussion, members concurred that the U.S. economy was likely to continue to recover at a moderate pace. As positive factors, many members pointed to accommodative financial conditions, an increase in employment, and a decline in inflation rates, while as negative factors they cited bifurcation of employment, weak housing prices, and a further reduction in fiscal spending. Some members noted that, in the recovery phase following the Lehman shock, shifts between optimistic and pessimistic views regarding the U.S. economy had repeatedly occurred over short periods. They continued that uncertainty regarding a future recovery path was high in view of opposing forces working on the economy: relatively favorable conditions in the corporate sector and strains from balance-sheet adjustments in the household sector.

Members agreed that the pace of growth in emerging and commodity-exporting economies had moderated somewhat on the whole, mainly due to the impact of a decrease in exports induced by a slowdown in European economies, as well as the effects of a decline in real purchasing power -- incurred by the earlier rise in prices -- and of monetary tightening. A few members expressed concern that the adverse effects of the slowdown in European economies through international trade had started to materialize not only in geographically close Central and Eastern European countries but also in the NIEs and the ASEAN countries. Some members expressed the view that European financial institutions' reduction of their assets had not had a significant impact on emerging and commodity-exporting economies so far, since the reduction of their loan assets had not progressed well, although they had made some progress in terms of sales of their marketable assets. As for the outlook, most members recognized that the growth potential of emerging and commodity-exporting economies was still high, supported by various factors including progressing urbanization. They continued that inflation rates remained at high levels but were declining gradually, and if this trend continued, these economies' growth rates would increase again mainly through a recovery in households' real purchasing power. Some members said that, in such economies as China where inflation rates were starting to decline, room for monetary easing seemed to be expanding and this could lead to a soft landing, while not a few economies -- such as Brazil and India -- still faced difficulty in the conduct of monetary policy because inflation was not contained. These members expressed the view that there were growing disparities in terms of both economic activity and prices by country and region, and it had therefore become difficult to make an overall assessment. As a risk factor for the outlook for the Chinese economy, one member pointed to possible adverse effects of the decline in real estate prices on loans to small firms, and noted that the member was closely monitoring this factor.

Based on the above deliberations on economic and financial conditions abroad, members discussed the state of Japan's economy.

Regarding recent developments in the economy, members agreed that Japan's economic activity had been more or less flat, mainly due to the effects of the slowdown in overseas economies and the appreciation of the yen. They shared the view that exports and production remained more or less flat, due to the slowdown in overseas economies and the yen's appreciation, as well as the remaining effects of the flooding in Thailand. They concurred that business fixed investment had been on a moderate increasing trend, aided partly by the restoration of disaster-stricken facilities. They shared the recognition that private consumption remained firm, including services consumption. They also agreed that housing investment had generally been picking up and public investment had stopped declining. As background to the continued firmness in domestic demand, particularly in private consumption, some members pointed to the possibility that, in addition to the materialization of demand that had been temporarily restrained after the earthquake, the positive effects of the yen's appreciation on domestic demand had spread, but to a limited degree. A few members commented that they were paying attention to signs of improvement in the employment situation, as suggested by the ratio of job offers to applicants and the number of regular employees in the *Monthly Labour Survey*, and to the fact that consumer sentiment had been steady as a whole.

As for the outlook for the economy, members shared the view that Japan's economic activity would remain more or less flat for the time being, but thereafter the economy was likely to return to a moderate recovery path as the pace of recovery in overseas economies picked up, led by emerging and commodity-exporting economies, and as reconstruction-related demand after the earthquake disaster gradually materialized. Regarding the reconstruction-related demand, some members expressed the view that there had already been developments such as the emergence of pent-up demand, especially in private consumption, spending for the purpose of rebuilding daily lives in the disaster areas, and the restoration of disaster-stricken facilities. They continued that further implementation of the large-scale third supplementary budget for fiscal 2011 would bring about more pronounced positive effects on economic activity.

Members agreed that the year-on-year rate of change in the CPI (all items less fresh food) was currently around 0 percent and likely to stay at this level for the time being. Some members added that, although crude oil prices had recently increased to some extent on the back of geopolitical risks, there appeared to be no significant changes in price developments so far.

B. Financial Developments

Members agreed that, although global financial markets remained under heavy strain, financial conditions in Japan continued to ease.

Members agreed that money market rates had been extremely stable as the Bank had been pursuing powerful monetary easing and the soundness of financial institutions' balance sheets had been maintained. They shared the view that issuing conditions for CP remained favorable and those for corporate bonds also remained favorable on the whole. They were of the view that firms' funding costs had declined moderately, and that the availability of funds remained on an improving trend. Some members commented that it was notable that the year-on-year rate of change in bank lending had been slightly positive due to an increase in lending to electric power companies and to demand for funds related to mergers and acquisitions.

Some members said that upward pressure on the yen, particularly against the euro, was persistent due to the prolongation of the sovereign debt problems in Europe and monetary easing in various economies, and that it was necessary to closely monitor whether this persistent pressure would exert downward pressure on Japanese stock prices and business sentiment, and consequently on economic activity. A few members noted that households' and firms' short-term inflation expectations had recently declined slightly. One of these members said that these changes in expectations seemed to have been driven by developments in the rate of inflation of fresh food and other items that were frequently purchased. A different member added that, with the decline in short-term inflation expectations, it was possible that the pace at which the rate of inflation converged with the long-term inflation anchor would become slow. A few members noted that it was necessary to gain a better understanding of (1) the fact that various prudential regulations and financial institutions' stronger preference for safe assets had activated such institutions' investment in government securities, and (2) the impact on the financial system of the rise in long-term interest rates. A different member said that, in view of a prolonged accommodative financial environment, it was necessary to make a careful examination of whether unintended imbalances might build up in the financial sector, including an assessment of business conditions for individual financial institutions.

C. Interim Assessment

Given the above assessment of recent developments, members concurred that growth prospects would likely be lower for fiscal 2011 compared with the forecasts presented in the October 2011 *Outlook for Economic Activity and Prices* (hereafter the

Outlook Report). They shared the view that the lower growth prospects for fiscal 2011 were also attributable to a technical factor -- namely, a smaller carry-over effect from fiscal 2010, which lowered GDP growth for fiscal 2011, in accordance with the revision of past GDP statistics -- in addition to a material factor of sharper-than-expected deceleration in the pace of growth in overseas economies, due mainly to the effects of the sovereign debt problems in Europe. They agreed that the baseline scenario in the October 2011 Outlook Report -- namely, that Japan's economy was likely to return to a moderate recovery path -- was being maintained, although the timing of a recovery was likely to be slightly delayed to the first half of fiscal 2012, and that growth prospects for fiscal 2012 and 2013 would likely remain broadly unchanged. One member added that slight downward revisions to the member's forecasts of GDP growth for both fiscal 2012 and 2013 had been made, taking into consideration that exports and business fixed investment would be weaker due to the effects of appreciation of the yen, the slowdown in overseas economies, and sluggish stock prices, although these forecasts were broadly within the projected range in the October Outlook Report.

With regard to prices, members concurred that the year-on-year rates of change in the CGPI and the CPI (all items less fresh food) were likely to be broadly in line with the October forecasts. Regarding the outlook for the CGPI, they shared the view that an increase in firms' electricity charges announced by The Tokyo Electric Power Company would exert upward pressure in fiscal 2012, but this would be generally offset by a decline in the prices of international commodities -- other than crude oil -- which had previously been rising. With regard to the background to the forecast that developments in the CPI for fiscal 2012 were likely to be in line with the October forecasts, one member explained that upward factors such as the upward revision to the member's forecast for crude oil prices were generally offset by a downward factor, that is, the slower pace of improvement in the negative output gap. As for the outlook for the CPI, one member acknowledged having made slight downward revisions to the member's forecasts, mainly due to sluggish inflation expectations, although the Bank's baseline scenario was being maintained and these forecasts were broadly within the projected range in the October Outlook Report. Some members expressed the view that some more time was needed to confirm that price stability was in sight on the basis of the "understanding of medium- to long-term price stability" (hereafter "understanding"), but Japan's economy had been making steady progress toward a sustainable growth path with price stability in the longer run.

In terms of risk factors for the economic outlook, members agreed that uncertainty about future economic developments at home and abroad was high, and that the effects of the sovereign debt problems in Europe in particular continued to represent the most significant risk. Regarding these sovereign debt problems, many members pointed to the following specific triggers that could intensify the strains in global financial markets: (1) the outcome of the refinancing of government bonds issued by countries with fiscal concerns and of corporate bonds issued by European financial institutions, which would mostly take place over the spring; (2) consequences of the negotiations to reduce the Greek government's debts and of the second bailout package for Greece; (3) European financial institutions' reduction of their assets in order to raise their capital ratios; and (4) a potential further downgrading of European government bonds. Members shared the view that attention should be paid to the possibility that, if these event risks materialized, they could lead to weaker growth in overseas economies -- and consequently in Japan's economy -- through their effects on global financial markets. With regard to uncertainty over the outlook for the U.S. economy, many members said that -- although downside risks had decreased -- strains from balance-sheet adjustments, downward pressure on economic activity from the fiscal side, and a spreading of the effects of sovereign debt problems in Europe continued to warrant attention. Regarding risks to the outlook for emerging and commodity-exporting economies, members shared the view that there remained a high degree of uncertainty about whether these economies -- including China, where the inflation rate had been declining recently -- could make a soft landing by achieving price stability and economic growth at the same time. Many members commented that, should European financial institutions accelerate the pace of reducing their assets, the subsequent impact on emerging and commodity-exporting economies, including those in Asia, would inevitably become significant. As for the effects of the sovereign debt problems in Europe, a few members noted that it was also necessary to pay attention to the risk that increased risk aversion among investors would lead to a rapid outflow of funds from the capital markets in emerging economies. Some members raised the following as risk factors unique to Japan's economy: (1) uncertainty over electricity supply with regard to the timing of resumed operations at the nuclear power plants; and (2) a delay in the implementation of the reconstruction-related budget.

As for risk factors for the outlook for prices, members agreed that considerable uncertainty surrounded future developments in international commodity prices. Noting the recent slight rise in crude oil prices, reflecting concerns about geopolitical risks associated with the situation surrounding Iran, they shared the view that a worsening of this situation could have a significant impact on overseas economies, as well as Japan's economy, through a sharp rise in crude oil prices, and therefore future developments warranted careful monitoring. A few members expressed the view that, given that it was likely to take time before positive inflation was established, attention needed to be paid to the possibility that firms and households would have increased expectations that prices were unlikely to rise even in the medium to long term, in turn causing a weakening in actual price developments.

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

Regarding the guideline for money market operations for the intermeeting period ahead, members agreed that it was appropriate to maintain the current guideline that the Bank would encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent.

With regard to monetary policy for the immediate future, members shared the recognition that, in order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, it was necessary for the Bank to continue to consistently make contributions as the central bank by pursuing powerful monetary easing through the comprehensive monetary easing measures, ensuring financial market stability, and providing support to strengthen the foundations for economic growth. Some members expressed the view that the financial spillover effects on Japan's economy of the sovereign debt problems in Europe had been contained so far, as the comprehensive monetary easing measures had been effective in generating significant monetary easing effects. Some members commented that it was important for the Bank to be well prepared to take policy actions -- including measures to stabilize the financial system -- as the central bank, bearing in mind the risk that the sovereign debt problems in Europe could cause a serious shock to global financial markets and the global economy, thereby affecting the financial system and financial conditions in Japan. One member expressed the view that it was necessary to examine future possible actions while carefully considering the need to further enhance monetary easing, such as through an increase in the total size of the Asset Purchase Program (hereafter the Program), as well as the risks and costs associated with the unconventional policy measures.

Regarding the policy time horizon of the Bank's policy interest rate, members shared the view that it was of critical importance that the Bank explain even more persistently to the public that it would maintain the virtually zero interest rate policy until it judged that price stability was in sight on the basis of the "understanding." Some members added that, from the perspective of the transparency and effectiveness of monetary policy, presenting the policy time horizon in this manner was appropriate given the current developments in Japan's economy. They continued, however, that it was important for the Bank to review its communication to the public on a continual basis, bearing in mind that the Federal Reserve had been reviewing its own communication policy. One of these members noted that, in communicating to the public, it was necessary for the Bank to clearly explain that the stimulative effects on the economy brought about by the measure regarding the policy time horizon would strengthen gradually as the economy recovered.

With regard to the Program, members shared the view that it was appropriate to steadily implement it mainly through the purchase of financial assets, and to monitor the spread of its effects. Some members expressed the view that the undersubscription that had recently occurred in the Bank's outright purchases of corporate bonds and T-Bills under the Program, as well as a decline in the bid-to-cover ratios of the fixed-rate funds-supplying operation against pooled collateral with a six-month term, indicated that the effects of the Bank's significant monetary easing had been spreading to financial markets. One of these members, after commenting that undersubscription might continue to occur depending on the situation in financial markets, noted that it was important for the Bank to continue to reassure market participants by steadily conducting its operations under the Program. A different member expressed the view that, considering that the Program was introduced in order to enhance monetary easing, it was necessary that the Bank make further efforts to complete the purchases -- bearing in mind that the term for accumulating the outstanding amount of the Program was due to terminate at the end of December 2012. One member expressed the opinion that, although prices of Japan real estate investment trusts (J-REITs) had recently been weak due to risk aversion among investors, it could be considered that the Bank's purchases of J-REITs under the Program continued to bring about a certain positive effect in terms of reassuring market participants.

With regard to the lowering of the interest rate on the Bank's U.S dollar funds-supplying operation against pooled collateral, which was decided at the end of November 2011, many members reaffirmed their view that this move had been considerably effective in bringing down the rates on U.S. dollar funding through foreign exchange swap markets since the beginning of 2012 amid financial institutions' brisk bidding for funds.

As for the fund-provisioning measure to support strengthening the foundations for economic growth, a few members expressed the view that, although the total amount of the Bank's loan disbursement under the special rules for equity investments and asset-based lending (ABL) remained relatively small, it was playing the role of a catalyst. On this basis, these members commented that it was necessary for the Bank to continue to encourage financial institutions' initiatives to utilize ABL.

IV. Remarks by Government Representatives

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

(1) The government submitted the fourth supplementary budget for fiscal 2011 and the budget for fiscal 2012 to the Diet on January 24. It would do its utmost to promptly obtain the Diet's approval of the two budgets.

(2) On January 6, the Headquarters of the Government and Ruling Parties for Social Security Reform decided the draft plan of the comprehensive reform of social security and taxation systems. The government would submit to the Diet related bills on fundamental reform of the tax system -- including amendments to the Consumption Tax Act -- by the end of fiscal 2011, with the aim of securing stable financial resources for social security functions and at the same time achieving fiscal consolidation. The government deemed that it shared with the Bank the same view on the importance of achieving fiscal consolidation.

(3) The draft plan of the comprehensive reform of social security and taxation systems stated that the government had been working closely with the Bank to overcome deflation and would continue to take appropriate economic and fiscal policy measures to prevent an economic slowdown. The plan also stated that the government would work toward achieving the revitalization of the Japanese economy by taking additional measures to overcome deflation and stimulate economic activity. The government

deemed it important to do its utmost with regard to the future conduct of economic management.

(4) The Bank's interim assessment of the October 2011 Outlook Report was discussed at this meeting. The Bank projected that the year-on-year rate of increase in the CPI would only be modest until fiscal 2013, and that the rates of change would stay low compared to the "understanding," in which the year-on-year rate of change in the CPI centered around 1 percent. Furthermore, there was a significant risk that the sovereign debt problems in Europe could cause a downturn in overseas economies through their effects on the European financial system and global financial markets, and thereby lead to an economic slowdown in Japan. The government hoped that the Bank would share its view on the current severe economic conditions and conduct monetary policy appropriately and decisively, with a view to overcoming deflation and preventing an economic slowdown while sufficiently exchanging views and keeping close contact.

The representative from the Cabinet Office made the following remarks.

(1) The Japanese economy was picking up slowly, and was expected to continue to pick up moderately. In the "Fiscal 2012 Economic Outlook and Basic Stance for Economic and Fiscal Management," real and nominal GDP growth rates for fiscal 2012 were expected to be around 2.2 percent and 2.0 percent, respectively. The risk of the sovereign debt problems in Europe causing a downturn in overseas economies and subsequent economic slowdown in Japan required strong vigilance.

(2) With regard to the year-on-year rate of change in the CPI for fiscal 2013, the median of the Policy Board members' forecasts at this meeting was 0.5 percent in the Bank's interim assessment, which was low compared to the "understanding." In order to smoothly carry out the comprehensive reform of social security and taxation systems, it was necessary for the government and the Bank to work more closely and take a firmer stance on overcoming deflation.

(3) The government deemed it necessary to work toward narrowing the negative output gap in order to overcome deflation. It would swiftly and steadily implement the "Comprehensive Package Responding to the Yen Appreciation" as well as the third and fourth supplementary budgets. Furthermore, with a view to raising the potential growth rate and increasing the private sector's appetite for investment, the government

would advance its efforts to strengthen Japan's growth potential by formulating the "Strategy for Rebirth of Japan."

(4) The government deemed it extremely important to work closely with the Bank toward quickly achieving a stable and positive inflation rate. At the meeting held by Prime Minister Yoshihiko Noda and Governor Masaaki Shirakawa on January 17, it was agreed that such meetings would continue to be held regularly with a view to promoting an exchange of views. The government expected the Bank to make its utmost efforts in the conduct of monetary policy in parallel with the government's measures to overcome deflation and stimulate economic activity. It hoped that the Bank would take decisive actions to overcome deflation, including those aimed at attaining the year-on-year rate of change in the CPI centering around 1 percent presented in the "understanding" at an early stage and those aimed at enhancing communication with markets.

V. Votes

Based on the above discussions, members shared the view 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 to 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 to 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, Mr. S. Nakamura, Mr. H. Kamezaki, Mr. R. Miyao, Mr. Y. Morimoto, Ms. S. Shirai, and Mr. K. Ishida.

Votes against the proposal: None.

VI. Discussion on the Statement on Monetary Policy

Members discussed the Statement on Monetary Policy, and it was put 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 December 20 and 21, 2011 for release on January 27, 2012.

Attachment

January 24, 2012

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,[6] 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 to 0.1 percent.

2. Japan's economic activity has been more or less flat, mainly due to the effects of a slowdown in overseas economies and the appreciation of the yen. As for domestic demand, business fixed investment has been on a moderate increasing trend and private consumption has remained firm. On the other hand, exports and production have remained more or less flat, due to the slowdown in overseas economies and the yen's appreciation as well as the remaining effects of the flooding in Thailand. Meanwhile, although global financial markets remain under heavy strain, financial conditions in Japan have continued to ease. The year-on-year rate of change in the CPI (all items less fresh food) is around 0 percent.

3. As for the outlook, Japan's economic activity will remain more or less flat for the time being. After that, the economy is expected to return to a moderate recovery path as the pace of recovery in overseas economies picks up, led by emerging and

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

commodity-exporting economies, and reconstruction-related demand after the earthquake disaster gradually materializes. The year-on-year rate of change in the CPI is expected to remain at around 0 percent for the time being.

4. Compared with the forecasts presented in the October 2011 *Outlook for Economic Activity and Prices*, growth prospects will likely be lower for fiscal 2011, due to the revision of past GDP statistics in addition to the slowdown in overseas economies. Nevertheless, growth prospects for fiscal 2012 and 2013 will likely remain broadly unchanged because the economy is expected to gradually return to a moderate recovery path in the first half of fiscal 2012. With regard to prices, the year-on-year rates of change in the domestic corporate goods price index and the CPI (all items less fresh food) are expected to be broadly in line with the October forecasts.

5. Regarding risks to the economic outlook, the sovereign debt problem in Europe could result in weaker growth not only in the European economy but also in the global economy particularly through its effects on global financial markets. In the United States, strains from balance-sheet repair continue to weigh on the economy despite some firmness observed recently. As for emerging and commodity-exporting economies, there remains a high degree of uncertainty about whether price stability and economic growth can be realized at the same time. Careful attention should continue to be paid to how Japan's economy will be affected by the above uncertainty regarding financial and economic developments overseas. Regarding risks to the price outlook, considerable uncertainties including the effects of geopolitical risk surround future developments in international commodity prices. There is also a possibility that the rate of inflation will deviate downward from the Bank's baseline scenario due, for example, to a decline in medium- to long-term inflation expectations.

6. The Bank is committed to continuing the virtually zero interest rate policy until it judges that price stability is in sight on the basis of the "understanding of medium- to long-term price stability."[7] It has also enhanced monetary easing by repeatedly

[7] The current understanding on the basis of a year-on-year rate of change in the CPI is "a positive range of 2 percent or lower, centering around 1 percent."

expanding the size of the Asset Purchase Program on a significant scale, and is steadily implementing the Program mainly through the purchase of financial assets. In order for Japan's economy to overcome deflation and return to a sustainable growth path with price stability, the Bank will continue to consistently make contributions as the central bank by pursuing powerful monetary easing through the comprehensive monetary easing measures as described above, ensuring financial market stability, and providing support to strengthen the foundations for economic growth.

Appendix 1

Forecasts of the Majority of Policy Board Members

y/y % chg.

	Real GDP	Domestic CGPI	CPI (all items less fresh food)
Fiscal 2011	-0.4 to -0.3 [-0.4]	+1.8 to +1.9 [+1.8]	-0.1 to 0.0 [-0.1]
Forecasts made in October 2011	+0.2 to +0.4 [+0.3]	+1.7 to +2.0 [+1.8]	0.0 to 0.0 [0.0]
Fiscal 2012	+1.8 to +2.1 [+2.0]	-0.1 to +0.2 [+0.1]	0.0 to +0.2 [+0.1]
Forecasts made in October 2011	+2.1 to +2.4 [+2.2]	+0.1 to +0.3 [+0.2]	0.0 to +0.2 [+0.1]
Fiscal 2013	+1.4 to +1.7 [+1.6]	+0.6 to +1.0 [+0.8]	+0.4 to +0.5 [+0.5]
Forecasts made in October 2011	+1.3 to +1.6 [+1.5]	+0.7 to +0.9 [+0.8]	+0.4 to +0.6 [+0.5]

Notes: 1. Figures in brackets indicate the median of the Policy Board members' forecasts (point estimates).

2. The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate, namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.

3. Individual Policy Board members make their forecasts with reference to the view of market participants regarding the future course of the policy interest rate -- a view that is incorporated in market interest rates.

4. The revision in the forecasts for real GDP in fiscal 2011 is also attributable to a smaller carry-over effect from fiscal 2010 on GDP growth for fiscal 2011, reduced by approximately 0.5 percentage points, in accordance with the revision of past GDP statistics.

5. CPI using the Chain-weighted Index Formula has also been released as a reference. Based on this chain-weighted index, the year-on-year rate of change in the CPI around fiscal 2013 may be slightly lower than the above forecasts based on the Fix-weighted Index Formula.

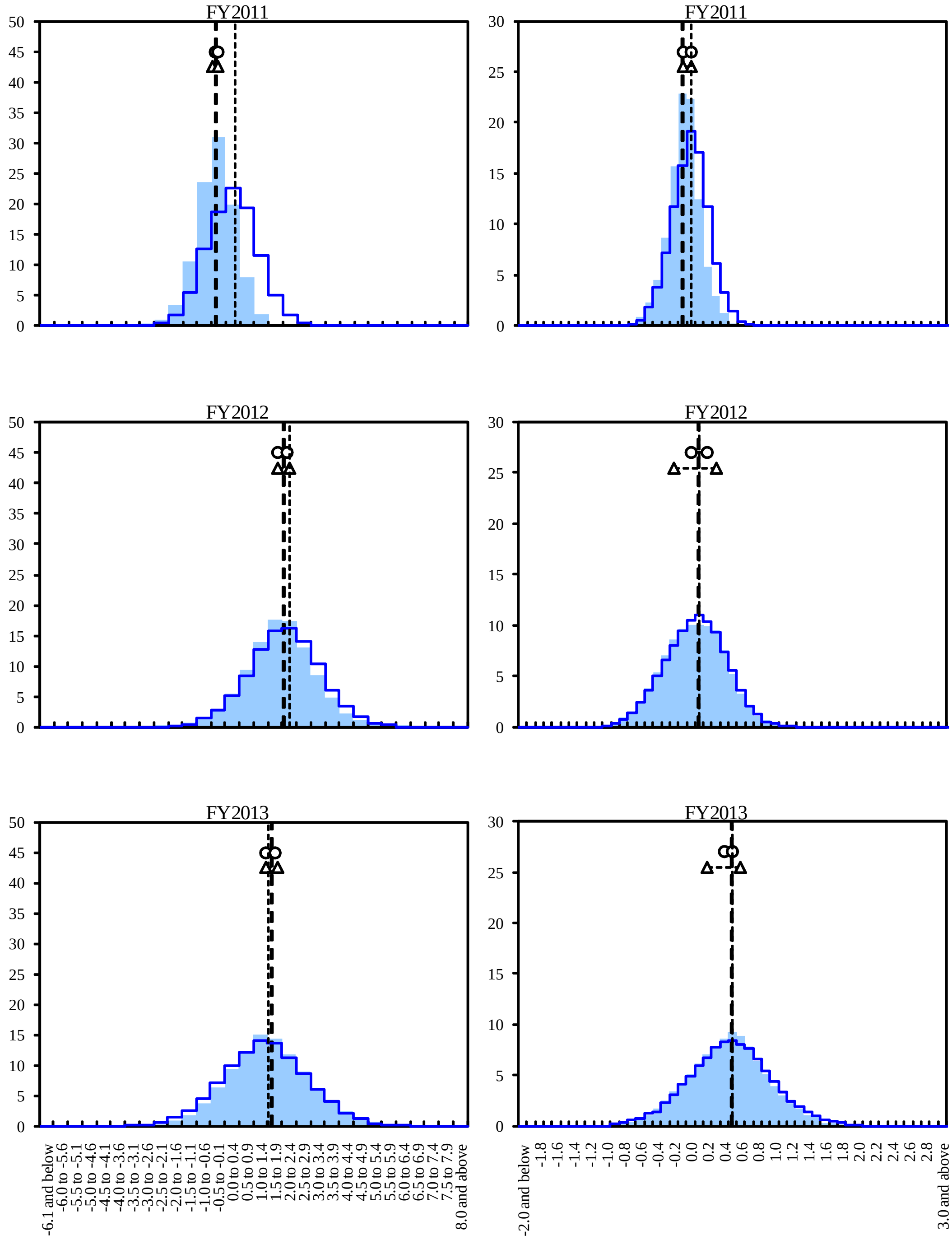
6. The ranges shown below include the forecasts of all Policy Board members.

y/y % chg.

	Real GDP	Domestic CGPI	CPI (all items less fresh food)
Fiscal 2011	-0.5 to -0.3	+1.7 to +1.9	-0.1 to 0.0
Forecasts made in October 2011	+0.2 to +0.4	+1.7 to +2.1	-0.1 to +0.1
Fiscal 2012	+1.8 to +2.2	-0.2 to +0.2	-0.2 to +0.3
Forecasts made in October 2011	+2.0 to +2.4	+0.1 to +0.4	-0.1 to +0.3
Fiscal 2013	+1.4 to +1.8	+0.5 to +1.0	+0.2 to +0.6
Forecasts made in October 2011	+1.2 to +1.7	+0.6 to +1.0	+0.3 to +0.7

Risk Balance Charts

(1) Real GDP (2) CPI (All Items Less Fresh Food)



Notes: 1. Vertical axes in the charts represent probability (%), while horizontal axes represent the year-on-year percentage changes in the respective indicators. Bar charts represent the probability distributions in January 2012, and solid lines represent those in October 2011.

2. Heavy vertical dashed lines indicate the median of the Policy Board members' forecasts (point estimates). indicates the range of the forecasts of the majority of Policy Board members. indicates the range of the forecasts of all Policy Board members.

3. Thin vertical dashed lines indicate the median of the Policy Board members' forecasts (point estimates) in October 2011.

4. For the process of compilation of the Risk Balance Charts, see the box on page 9 of the April 2008 *Outlook for Economic Activity and Prices*.