Notes on Financial Markets Vol.56

Initial impression of the press conference of Governor Shirakawa

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Press briefing:

It might not be known well that Mr. Shirakawa, Governor of the Bank of Japan holds press conference after every meeting of the monetary policy. Possible reasons would include that there was no way to watch it unless you attend as the press, and that it is conducted only in Japanese.

Thanks to Nikkei (Japanese Newspaper), however, we are now able to watch its webcast (with some delay and in Japanese). After watching the today's conference on the policy decision by the BOJ, I discuss several interesting points which may have long-term implications.

Point 1: Time frame to reach the goal

As I wrote in my previous note, the outside observers may wonder the reasons of the series of the BOJ's monetary stimulus when they have been upgrading economic assessments. Today it happened again. Therefore, in fact, a few attendants of today's conference raised this issue.

Governor Shirakawa insisted the idea that the BOJ would like to support recent positive developments. He may be successful in making the markets remind of the norm that the policy decisions should be more dependent on the longer-term economic developments. The BOJ could avoid unnecessary volatility before every monetary policy meeting depending on the most recent economic indicators.

The tougher challenge, though, for the BOJ is to show the time frame to reach the goal. On one hand, it is apparently desirable in order to stabilize our economic/financial activities. On the other hand, it is also apparently hard to expect the time of reaching the goal. In addition to technical difficulties of making accurate long-term outlook, as Governor suggested at today's conference, it is considerably difficult to show the prospects of deflation when there remain diversified views of our persistent (but mild) deflation.

Simplest option for the BOJ might be to add the "long-term" expectation of inflation (as 1%) to their semi-annual economic outlook. This is the conventional style of the FRB. This would not function, however, for the BOJ, because they explain that 1% inflation is a goal " for the time being". Even if the BOJ put 2% inflation as the longer-term expectations, the BOJ could lose confidence due to the lack of measures for reaching this higher goal within meaningful time.

As already reported widely by the press, Governor Shirakawa tried to overcome this challenge at the press conference by mentioning that the inflation rate would increase to 1% sometime in 2014. While this is not included formally in the semi-annual outlook, Governor Shirakawa's reference is the strong message to the market, because his comment could enhance the BOJ's commitment to the current policy stance. I also feel that the BOJ's framework may get closer to a formal inflation targeting.

Point 2: Optimal policy strategy

As I discussed in the previous "Note", it has been uncertain whether the BOJ finally accepted the claim by their opponents that the deflation has been the monetary phenomenon and it should be addressed by further expansion of fund provision. Such speculation seems to be consistent with the policy actions on February 14, while it may contradict the idea that may led to enhance the Growth-Supporting Funding Facility (GSFF) on March 13.

Today's policy decision suggests that the BOJ may maintain their traditional policy strategy against deflation through the acceleration of our economic growth (rather than the direct impact of fund injection). Both the section 4 and 6 of today's policy statement emphasize their line of thoughts. Moreover, Governor Shirakawa explained that changes in the asset prices by BOJ's purchase would stimulate economic activities, as an answer to an famous BOJ watcher at Reuters.

These arguments would also have the benefit of clarifying the intension of the asset purchase program. As Governor Shirakawa mentioned today, the BOJ has been trying to depress longer-term rates and risk premia under their "comprehensive easing" since the autumn of 2010. Such idea is also consistent with the reduction in the amount of 6-month money market operations today.

It should be noted, however, those of "reflationary" school would not appear to be persuaded or to stop requiring the BOJ to expand the scale of monetary base. With this respect, along with the cause of our deflation, we would need further time of debate.

Point 3: Policy mix

Before the today's policy decision, there had been a growing view in our markets that the BOJ would minimize the increase in JGB purchase as a part of the asset purchase program. One possible reason was the skepticism against JGB purchase suggested in Governor Shirakawa's speech recently in the US. Today's decision to increase JGB operation by ¥10tn may imply that such concerns were exaggerated.

There is a caveat, however. Unlike the case of the ECB (and the FRB to a lesser extent), it is highly usual that the BOJ clearly requires the efforts of fiscal consolidation (please see section 5 of today's statement). In effect, the BOJ requires the policy mix of fiscal tightening and monetary easing, even if the BOJ accepts expansion of JGB purchase.

Against these backgrounds, 4 out of 16 questions at today's conference asked the risk of monetization of fiscal deficits and its implications. One common reference point was the reasons for the extension of maturities of eligible JGB (from 2 years to 3years). Governor Shirakawa explained the conventional transmission of monetary policy (as discussed above), and insisted that 3 year would be in line with normal maturity of bank lending to corporate business.

While the latter fact may be consistent with the BOJ's policy strategy, an possible further extension of maturities of eligible JGB would require another set of reasoning, which could become a tough challenge. Moreover, as Governor Shirakawa implied, the "banknote rule" for JGB purchase could be breached as early as this year end. In any case, the BOJ need to introduce a new guideline to prevent concerns in the markets about "reckless" purchase of JGB, hopefully in collaboration with the government.

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