

Introduction

Governor Kuroda does not have to discuss imminent policy issues. This is not only because our economy performs well, but also because “balanced approach” of the fiscal package by Prime Minister Abe prevented the pressure on monetary policy to “neutralize” the possible downward pressure from consumption tax hike. As a result, most of the discussion at the press conferences on Friday had longer-term viewpoints. Let me review some of them that have important implications.

Balance of risks

The press reporters appeared to agree that our economy so far would not require any additional stimulus measures. Nevertheless, some of them raised the concerns about the economic outlook, notably in relation to the downside risk of global economy.

While some reporters expressed concerns about the potential impacts of fiscal problem in the US, more attention was paid to the outlook of emerging economies in the Asian region. They have good reasons to raise this issue. Japan’s economy is effectively more involved in the Asian supply chain and some of the major economies in the region seem to struggle to recover economic activities.

Governor Kuroda again admitted that the contributions from net external demand so far have been smaller than projected in April this year. He insisted, however, that the BOJ expects the gradual recovery of the global economy toward next year, which would support the momentum of our economic activities.

With regard to the economic outlook in Asian region, Governor Kuroda suggested that China could maintain the current rate of growth toward next year, and the south eastern economies could avoid further instabilities due to the fears about withdraw of international capital flows.

At least for now, we are in a rare condition that large part of our economic activities are “self-contained”. Nevertheless, we may not be so robust to external shocks, and still need to pay close attention to the global economic condition when non-negligible part of economic growth so far has been generated by fiscal stimulus policy (and it would not be repeated).

Inflation expectation

With regard to the inflation expectation as the core indicator for the QQE, there was again some interesting discussion.

Some reporters asked if the BOJ identified any improvements of inflation expectation. Readers may already be aware that households have shown substantial responses so far as implied by some survey results. In addition to this common knowledge, Governor Kuroda interestingly added that business firms may be modifying the expectation gradually. Among all, he implied some signs of improving pricing power in some sectors by referring to the results of most recent TANKAN survey.

If this is the case, inflation expectation could have some momentum and become broader-based. As a result, as Governor Kuroda explained to a question by a senior reporter, it would be easier to achieve the BOJ’s inflation target. Because the position of our Philips Curve would be higher under the same gap of aggregate demand and supply. This would be a positive surprise to the line of thoughts that are skeptic about the achievement of the target in 2015.

Although it may be too early to discuss its plausibility, we have mixed set of factors so far. On the one hand, as Governor Kuroda insisted that the inflation expectations may mostly be affected by the recent history of actual inflation. Readers may like to note that this is different idea from the “shock and awe” strategy in April. Nevertheless, from his viewpoint, faster pace of inflation (for whatever reasons) could be encouraging as far as it could become a source of expectations.

On the other hand, increase in the pace of CPI inflation has largely be driven by rising commodity prices coupled with depreciation of JPY. In other words, CPI inflation excluding fresh foods and energy has barely exited from deflation. Moreover, this uncomfortable fact could result in negative reactions to inflation by households that would prevent stronger pricing power by business firms.

Apparently, households reactions could also depend on their income conditions. We could argue in some different ways. We could have some confidence in employment situations as suggested by TANKAN survey, but we are still uncertain whether the increase in the wage rate could be sustained.

Policy commitment

Although we may have better prospects of inflation as discussed in the previous section, it would be reasonable to think that it is uncertain in light of many moving parts ahead. Therefore, the potential reaction by the BOJ if it becomes clear that the target could not be achieved has gradually attracted attention by domestic market participants and financial media.

Concerning this important issue, we may have received a clue. Governor Kuroda mentioned that the duration of the QQE could become either shorter or longer than 2 years depending on the performance of our inflation. Taking account of this comment, the BOJ may maintain the QQE as long as the target could not be achieved.

This may effectively function as an enhancement of policy commitment. In light of recent cases of introduction of forward guidance by some central banks in Europe, they have strengthened the effects of monetary stimulus in general.

Nevertheless, the condition for the BOJ seems to be complicated. The tough challenge for the BOJ when they would like to enhance monetary easing would be the reasonable choice of policy option. As readers may agree, a “shock and awe” strategy would not only be ineffective next time, but also could trigger another set of problem.

The result of a small survey by Nikkei last week suggested that the market appears to think an incremental increase of the scale of operation (ironically similar to Comprehensive Easing) would be a possible option. Alternatively, the general public could be satisfied with better economic performance with less deflationary minds, regardless of 2% inflation in 2015.

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