Notes on Financial Markets Vol.93

Press conference by Governor Kuroda – Diversified adjustment

15 July 2014

Introduction:

At the mid-term review, the policy board of the BOJ left its semi-annual outlook of economy and prices mostly unchanged. While large part of the discussion at the press conference was on the implication of Governor Kuroda's recent speech, I still noticed some interesting points.

Outlook of economy and prices

Governor Kuroda's speech on June 23 has attracted so much attention by the markets, because, according to the text, he allegedly admitted the possibility that CPI inflation could decelerate to the pace around 1% in this summer. Even if this would be the case, it would not drastically alter our economic development throughout FY 2014. Nevertheless, this could increase the risk of under-shooting of our CPI inflation against the 2% target (sometime in FY2015).

A number of press reporters raised this issue and asked Governor Kuroda for its implication. To their disappointment, however, Governor Kuroda denied their speculation that this was a "silent" downward revision of the BOJ's view. He rather intended to claim by his speech that the inflation target would be achieved as originally scheduled, even in spite of short-term deceleration of inflation. In fact, the BOJ's new outlook of inflation announced today did not change from its April version.

Furthermore, Governor Kuroda said that CPI inflation rate would not become smaller than 1% even at its bottom for the time being. It would be reasonable for Governor Kuroda to make such strong statement in order to correct misunderstandings in the markets. In my view, however, it might be too strong argument in light of some macro-risks surrounding us in months ahead.

In any case, only and marginal revision of the outlook is the projected rate of economic growth for FY 2014 (+1.1%→+1.0% as median). According to the comments of Governor Kuroda, some MPM members observed slightly weaker recovery from the shock of consumption tax hike in April, especially in terms of durable goods sales.

Equilibrium interest rate

A reporter asked Governor Kuroda at today's press conference whether the current level of long-term JGB yields would be consistent with our economic development toward 2% inflation sometime in FY 2015. Readers would agree that this has been one of the FAQs on the QQE since last April.

Governor Kuroda pointed out several factors that might have driven the rates down. Interestingly, at first, Governor Kuroda explained the hypothesis that there has been a diversified views on inflation outlook across the range of economic agents. As I wrote in the previous Notes, inflation expectation of households have shown strongest and quickest improvements by the QQE or "Abenomics" as a whole. It has been gradually followed by corporate sector, as the recent series of TANKAN surveys suggest. In contrast, experts in our financial markets especially on fixed income front have been cautious about or reluctant to this scenario.

As a second (but probably most important) factor, Governor Kuroda mentioned that low JGB yields have been the intended policy effect by the QQE, among all by the extremely large scale purchase of JGB. Governor Kuroda added that some correlation with long-term yields in the US and Europe could have played some roles (without referring to its backgrounds).

Like the case for the FRB in previous years, the BOJ would like to maintain the low long-term yields until the central bank becomes confident in the strength of economic recovery. With this respect, the second factor by Governor Kuroda , namely the intended effects of asset purchase would be self-contained.

In contrast to the US, however, we should note that the incremental decrease in long-term JGB yields since the introduction of the QQE has been much smaller. This is in fact largely due to the fact that the JGB yields were already low with the backgrounds of dis-inflation for years. The BOJ would also claim that the maintenance of low yields would be sufficient as a policy effect. Nevertheless, I guess this could become an important issue for the BOJ's policy strategy.

More important issue would be the stability (or the sustainability) of cautious outlook of inflation by the markets as suggested by Governor Kuroda as the first factor above. A possible implication of this line of argument could be that the low JGB yield might be crucially dependent on the pace of adjustment of inflation outlook by the markets.

If such adjustment would be consistent with the strength of our economic recovery, upward pressure on JGB yields could be managed in the markets. While we need to be cautious about the distribution of costs across a range of financial institutions, improvements in the values of other financial assets could compensate for such costs as a whole financial system.

Some members of our Financial Markets Panel always remind me that previous cases of substantial changes of sentiments in the markets, especially on fixed income front, tended to be triggered by concerns about fiscal discipline. All in all, any line of discussion on the maintenance of the stability of JGB yields may lead to the importance of fiscal consolidation.

Interval of policy meeting

At the end of press conference today, a reporter asked whether the BOJ would follow the practice by the ECB in terms of the interval of policy meeting. Governor Draghi mentioned this month that the ECB would alter the interval to six weeks. As the reporter implied, the practice by both the FRB and the ECB could become a "global" standard. In fact, some BOE official hinted to consider the same practice.

While Governor Kuroda mentioned that the MPM had not discussed this issue, it would somewhat be beneficial for the BOJ. It would not only give some holidays to the staff, but also prevent the possible painful discussion at every press conference in FY 2015 whether the inflation target would be stably achieved. While it should be judged from medium-term perspectives, we could always like to ask this question as long as inflation rate crawls around 2% as expected.

Unfortunately, however, there is a unique hurdle for the BOJ to follow the practice. I would return to the answer in the next issue of this Note.

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