

Introduction:

Having observed a series of economic indicators, it became clearer that the economic growth so far this year was much weaker than the BOJ previously projected. Nevertheless, it could still be possible to argue that the worst is already behind us, and that we could return to an expansion path. This line of thoughts coupled with secure but slow economic growth could in the end shift our attention to the politics.

Minimal revision of statements

The BOJ revised their policy statements this month by the following points. 1) They simply describe the housing investment to be weak rather than in the recovery process. 2) They also saw weakness in industrial production, but maintained the scenario of gradual recovery.

Markets as well as press reporters seemed to wonder why the BOJ did not make any revision of evaluations of private consumption, because most of the recent weak indicators were found in this area. In response to the question raising this issue, Governor Kuroda insisted that we may be observing early signs of labor income improvements, although he admitted that weakness in private consumption was not what the BOJ previously projected.

One important factor that complicates the discussion has been the effects of consumption tax hike. While they could only have “temporary” impacts that will diminish in April 2015, they actually drag the real wage downward at meaningful magnitude without fast rises in nominal wages. Thus the markets now suspect that slower recovery of private consumption after tax hike has been largely driven by this negative real wage shock.

Taking account of the lines of discussion on the both sides, the issue is whether we could expect some significant rise in nominal wages in coming months when it was hard to find it so far. On the one hand, the BOJ maintains their view that nominal wage rises would be possible because of the tightening labor conditions. On the other hand, markets doubts this possibility either because of weak confidence in sustainable economic growth or because of their views that tightening labor supply is limited due to mismatch of skills .

In any case, we may have to wait at least several more months before the BOJ and markets could identify a shared scenario of real wages.

Contributions of net exports

Another venue of our macro-economy that was a source of disappointment to the BOJ is lower elasticity of our export. In fact, this has been a reason for lackluster net exports in spite of large depreciation of JPY, although “structural” increase in imports due to obvious reasons has doubtlessly made considerable contributions.

Again in response to a question by reporter, Governor Kuroda reiterated the view that large part of underperformance of our exports is driven by cyclical factors such as slow economic expansion of neighboring economies. There is a growing discussion in the markets, however, weaker response of our exports to depreciation of JPY may be related to structural factors including substantial shift in production capacity to overseas economies, or losing competitiveness of some major products in the global markets.

Thus the most important issue is again whether cyclical factors or structural factors have been playing a dominant role. And again it would be difficult for us to draw a clear conclusion before we accumulate sufficient empirical evidences. From the viewpoint of policy making, the BOJ could keep their wait-and-see stance at this moment by persuading the markets that we could expect something favorable in coming months.

In theory, it would of course not be a long-lasting strategy unless something good – substantial improvements in nominal wages and/or cyclical increase in exports – actually happens. But in reality, it could be a meaningful strategy in Japan where it would in any case be hard to identify the most important factor under our slow and gradual growth environment.

This “identification problem” may be the reason why those who expect additional monetary stimulus now rely more on the political factors rather than the evaluations of economic fundamentals. Many of them tend to claim that the BOJ could be requested to take part in the stimulus package for smooth execution of a second round hike of consumption tax hike.

Fiscal consolidation

It would be interesting to find that many members of the new cabinet maintain their idea to rise the consumption tax rate for the second time, even if we have observed stronger negative reactions of our economy.

It would be needless to say that the BOJ strongly recommends the government to raise consumption tax rate again as a step toward fiscal consolidation. At the press conference, Governor Kuroda reiterated this position, because lack of fiscal discipline would bring about a considerably difficult conditions that could not be dealt with monetary or fiscal policy.

All in all, the cabinet, the government and the BOJ have a “common goods” of fiscal consolidation. This would be another reason for the markets to believe that additional monetary stimulus could be driven by political reasons. According to their line of thought , the BOJ could accept additional stimulus possibly in exchange for second round of consumption tax hike.

Apparent challenge for the BOJ under such policy strategy is sustainability. In light of our serious fiscal condition, the BOJ would definitely face the similar situations again and again in terms of fiscal consolidation. If the BOJ dedicates their monetary policy options to such policy strategies, their options could be easily exhausted far before our fiscal consolidation accomplished.

It is ironic that we might rather need to pay attention to political conditions in order to seek clues for prospects of monetary policy in later phase of QQE.

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