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Farewell press conference by Governor Kuroda

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Introduction

As the term of Governor Kuroda ended on April 8th, detailed analysis of his farewell press conference on the day before would not be relevant. Nevertheless, the discussion included several significant issues for prospective policy conducts by new Governor Ueda, formally appointed on April 9th.

Fundamental idea of the QQE

Mr. Kuroda explained that the reduction in real interest rates across the yield curve was the fundamental idea of the QQE. According to his comment, large scale JGB purchase was intended to reduce the nominal yields and strong commitment to achieve the inflation target was intended to increase inflation expectation.

In earlier phase of the QQE, however, markets understood that major intension of large scale JGB purchase was affecting inflation expectation. In fact, the communication by the BOJ confirmed this line of thought. A potential reason might be the requirement that the BOJ should appeal that the QQE was consistent with "reflationary" school of thoughts.

In any case, such understanding by markets paved the way to criticism that the QQE was not successful in promoting inflation expectation. In fact, especially since the comprehensive review of the QQE in 2016, only viable policy tool for anchoring inflation expectation has been the policy commitment as Mr. Kuroda admitted.

Ironically, inflation expectation finally recovered largely due to substantial increase in import prices, which is an exogenous factor for monetary policy. While Mr. Kuroda admitted such mechanism, he expressed the view that accommodative financial condition due to monetary easing provided favorable circumstances.

All in all, the idea of QQE proved to be valid for reducing nominal yields, but its effects on inflation expectation remained uncertain. This is the reason why the BOJ may like to maintain the flexibility of inflation expectation, for which the BOJ made substantial policy efforts for some decades. Readers may like to remember that new Governor Ueda explained that the goal of his term would be to finalize the idea of the QQE.

Affecting market expectations

Mr. Kuroda insisted that affecting market expectations would be more crucial for conventional monetary policy (CMP). He explained that only policy variable for CMP was guiding O/N market rate by conducting short-term instruments. In order to promote desirable shape and position of the yield curve, he claimed that affecting market expectation of future course of monetary policy is required.

In contrast, Mr. Kuroda discussed that a central bank needs to be less dependent on such transmission mechanism for unconventional monetary policy (UMP), as it could utilize broader set of policy instruments that could impact the yield curve more directly. Large scale purchase of long-term government bond is apparently the representative example.

While this line of argument appears to be reasonable, markets may have different perception. As discussed in the previous section, the BOJ seemed to emphasize in earlier period that affecting expectation might be the unique feature of the QQE.

More importantly, it should be noted that the QQE since the introduction of the YCC was intended to control directly the shape and position of the yield curve rather than promoting its favorable shape and position by affecting market expectations. With this regard, the feature of the YCC is beyond those of "common" UMP.

One interesting question is whether markets could adjust their "reaction function" to communication policy by the BOJ if the BOJ abandons the YCC in the future. Taking account of the experiences in the US and the Euro-area when the central banks normalized monetary policy, it would at least a tough challenge for our markets.

Achievement of inflation target

Interestingly, Mr. Kuroda explained that he noticed favorable developments of prices and wages toward achieving the inflation target in late 2019. He pointed out that economic recovery regained momentum and labor condition tightened at that time. Approach toward the 2% inflation was unfortunately prevented due to the impacts of Covid-19 both on domestic and overseas economies.

Markets may be surprised by this comment as Mr. Kuroda declined to admit some favorable signs at that time, and he confirmed the idea that discussing policy normalization would be too early. Taking account of the discussion above, Mr. Kuroda's intension seemed to be avoiding improvement of inflation expectation in such early phase.

Moreover, the fact that the BOJ declined to modify the YCC until last December despite heavy criticism was also consistent with such intension. In fact, markets and general public criticized the BOJ that monetary easing was the cause of rising import prices through depreciation of JPY. Retrospectively, the idea of the BOJ's policy was something like "high pressure economy" advocated in the US before 2020.

In this respect, however, the reason why Mr. Kuroda has suggested that the BOJ is again closer to achieve the 2%target is uncertain. Readers may like to remember that, at his speech in December, Mr. Kuroda insisted structural changes in wages and prices that could make it plausible to achieve the inflation target in sustainable manner. He reiterated the same line of discussion at his farewell press conference.

A potential explanation would be that Mr. Kuroda may like to claim the successful aspects of the QQE. While markets could agree with it, evaluation of balance between the achievements and the associated costs would be diversified.

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