

Introduction

Although the attention by markets were rather muted, I looked forward to today's press conference. This is because it was the first opportunity to discuss the outlook by the BOJ under its inflation targeting framework. Let me focus some of the interesting implications of Governor Kuroda's comments.

Point 1: Transmission of policy effects

Many press reporters expressed their disappointment at the fact that the BOJ's outlook does not include more detailed accounts of the transmission mechanism of the new policy framework than the original statement on April 4.

In a sense, this kind of criticism may not be fair to the BOJ. They prioritized to send the simple policy message to the markets and the economic agents at large. That is why the volume of the executive summary – "The Bank's View" in their terms – was significantly reduced. Moreover, we may need to wait until tomorrow when the full text of the outlook is released, before judging the fairness of the criticism.

Nevertheless, the BOJ has been expected to give more precise explanation of the intended impacts of the new policy measures on the inflation expectation, and their effects on the economic performances including the actual inflation. This is because the policy strategy by Governor Kuroda is significantly different from that by Mr. Shirakawa.

Interestingly, the BOJ refers to the intended policy effects as one of the four major positive drivers in their outlook. Other three include the effects of increasing external demands, fiscal stimulus and structural economic reforms. In terms of the policy effects, only reference to the inflation expectation is its effects of reducing real interest rates.

While the economists may have already been aware that it is technically very hard to conduct quantitative analysis of the policy effects of the quantitative aspects of the new policy, more detailed account of the policy transmission by the inflation expectation has become the focused issue. And it is relating to the second point.

Point 2: Function as Inflation Report

One important implication of the point 1 above is the skepticism about the achievement of the inflation target within two years. Unfortunately, wider probability distribution for the expected inflation rate in FY2015 – while the median rate is 1.9% – may have supported to this skepticism. In fact, a number of press reporters referred to this fact.

In this respect, it could be argued that the new outlook did not function well as Inflation Report, if it could not induce the expectation of higher inflation.

Under the regime of the inflation target, the outlook of the inflation should not be a plain forecast of inflation. This is because the outlook should be based on the assumption of the optimal conduct of monetary policy, and such policy should be intended to achieve the target. The inflation outlook in Inflation Report could contribute to stabilize the inflation expectation at the desirable rate, as far as the outlook of inflation appears to be plausible.

Looking from the different perspectives, however, we could draw a contrasting implication.

As was reviewed above, the new outlook of the BOJ referred

to the "conventional" mechanism of unconventional policy measures including lower long-term yields and portfolio rebalancing. Moreover, wider probability distribution for the expected inflation rate in FY2015 implies that there may be diversified views among the members of the Policy Board in terms of the policy effects within this timeframe.

In spite of all these factors, the inflation outlook by the BOJ suggests that the CPI inflation in FY2015 could reach 1.9% as the median of collective expectation of the Policy Board. This could turn to reinforcing the view that we could expect the achievement of the target, even if we depend only on the conventional effects of the unconventional policy measures.

All in all, as the Bank's View version of the outlook mentions, dynamics of the inflation expectation have substantial uncertainties. It would be all the more true with our economy which have experienced chronic deflation (or very small rate of inflation). Of course, this is why Governor Kuroda introduced the set of drastic measures.

Point 3: Forward guidance

The BOJ's new inflation outlook for FY 2015 as 1.9% has two major points of implication in terms of "forward guidance".

First, as a press reporter suggested, the BOJ is expected to maintain its "quantitative and qualitative easing" at least through FY2015. While 1.9% inflation could be viewed as the achievement of the target, the BOJ announced their commitment on April 4 that it will maintain this new policy as long as it is necessary to maintain the target in a stable manner. Behind-the-curve exit of the forward guidance is its original idea, and the BOJ's own lessons from the past.

Second, the BOJ may have successfully secured a marginal flexibility for its inflation targeting. It should be noted that 1.9% is an average rate of inflation throughout FY 2015, which begins in April 2015 and ends in March 2016. Taking account of the BOJ's plan to manage monetary base toward the end of CY 2014 as well as Governor Kuroda's commitment that the target will be achieved in two years, some press reporters asked if the inflation target has been "re-scheduled".

Retrospectively, this sort of flexibility was thought to be inevitable. In fact, Mr. Kuroda and many proponents for the inflation target provided supports for the idea of "flexible inflation target" as they claim the global standard. Nevertheless, this appears to be on the boundary of flexibility, and further revision of the time frame could lead to an overall review of the target, which could undermine the significance of the inflation targeting – stabilizing the inflation expectation at the desired rate.

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