Notes on Financial Markets Vol.75

Press conference by Governor Kuroda — Higher JGB yields

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Introduction

At today's MPM, the BOJ maintained its QQE as originally introduced one and a half month ago. Also not surprisingly, dominant part of the press conference today was devoted to the discussion on JGB yields. Let me therefore concentrate to the issues relating to JGB markets as the review of the press conference by Governor Kuroda today.

Point 1: Backgrounds of the recent rise in yields

It was reasonable that several questions in the earlier part of today's conference dealt with this important issue. In reply, Governor Kuroda suggested his understanding that the long-term yields of JGB has been driven up in recent sessions as the reactions to accelerated pace of rise in stock prices and of depreciation of JPY as well as upward movement of US treasury yield.

While his comments may seem to imply the price dynamics of these markets could become self-reinforcing in the end, Governor Kuroda carefully added that he would not expect any acceleration of the rise in JGB yields. It was probably because the movements of these three elements are expected to be slower from his point of view.

At first glance, Governor Kuroda's line of argument was skillfully crafted to avoid the delicate issue: whether the recent rise of JGB yields has any fundamental economic reasons. In fact, the JGB market considerably reacted to some comments last week along the line of fundamental rationalization of higher yields. Governor Kuroda rather insisted that the BOJ would maintain flexible management of JGB operations in order to avoid unnecessary volatilities.

Nevertheless, the BOJ could not escape altogether from the fundamental story of the JGB yields. For example, if the recent rise of stock prices reflects the improved outlook of our economy - which appears to be reasonable - , the rise in JGB yields in reaction to stock prices should be regarded as the fundamental economic development. Governor Kuroda actually admitted that the asset purchase by central bank could only depress the risk premia in theory. This is in fact the "official" line of discussion on LSAP by the FED.

All in all, as a synthesis of these lines of thoughts, we might be able to argue that JGB yields in recent sessions have been driven by growing uncertainties about the effects of QQE in the long run. In addition, both stock prices and JPY rates have also been driven by this common factor. Interestingly, the uncertainty this time may contain some upward elements, and mean the growing correction of earlier skepticism to QQE.

Point 2: Costs of early rise in JGB yields

As the second phase of press conference, a number of reporters expressed some criticism against the early rise of JGB yields, because it could undermine the intended policy effects of QQE on our economy. Governor Kuroda effectively accepted such criticism. He insisted that lowering longer-term yield is the first pillar of the policy transmission of QQE. This is why he insisted the BOJ's commitment in flexible management of JGB purchase as above.

These exchange of views may have been off the point, however. While the earlier rise of JGB yields could have negative impacts on our economic activities as a matter of fact, we may need to take into account of the possible magnitude of the impacts, which may not be so crucial in the long run. For example, it would incur some higher costs of home lending, their absolute level would still be extremely low. Furthermore, if the recent rise of JGB yields has been driven by improvements of economic outlook at least to some extent, that part of higher yields would naturally be neutral to our fundamental economic activities.

Rather, the rising yield may have become an important issue, because it could have growing impacts on our fiscal conditions. This may be the very reason why the BOJ and the government should take care of JGB yields at such early stage of QQE, far earlier before we could see some strong signs of positive inflation and more robust economic growth.

Point 3: Policy instruments by the BOJ

From the technical point of view, the BOJ's flexible management of JGB purchase in terms of its pace, target maturity and frequency would be a meaningful policy factor. It may be all the more true if we recall the panicky reactions of some players in JGB markets, which accelerated the price actions especially in the earlier stage of recent high volatilities.

In considerations of some possible drivers of fundamental economies as discussed above, we may need to have another set of policy tool. In fact, Governor Kuroda insisted several times at today's press conference that growing balance of the JGB holdings by the BOJ through its continuous purchase in coming month could have stronger stabilizing effects in JGB market. It appears to be consistent with "stock view" of the effects of the asset purchase by central bank.

Furthermore, one additional prospective tool would be "verbal intervention" by the BOJ. Following the practices of Chairman Bernanke, Governor Kuroda could keep sending the policy message to the markets that the BOJ will always be ready to increase the amounts of JGB purchase when and if it judges necessary.

From the medium term perspectives, the market confidence in fiscal consolidation would be all the more important in light of the discussion on the Point 2 above. It is unfortunate, however, the BOJ would be in a weak position with this respect, because what the BOJ could do is to try to ask the government not to lose incentives for sound fiscal condition.

If you are optimistic, this line of thought would be relevant only for the period before our stronger economic growth in coming years would substantially reduce the risk of fiscal troubles. Recent reactions of JGB market would imply, however, that it could still take some time before the players in this market are fully persuaded by such a bright scenario.

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