Press conference by Governor Kuroda: Comprehensive assessment

July 29, 2016

Introduction

Announcement of a comprehensive assessment of QQE at the September meeting, rather than the modest set of additional stimulus, attracted substantial attention by broad range of observers in Tokyo. Before discussing it in detail, however, let me review the MPM's new outlook of economy and prices and their policy decision today.

Economic outlook

There are two major points of changes to MPM's outlook. First, expected rate of inflation for FY2016 was revised down from 0.5% to 0.1% (median). According to its text, it was due to earlier appreciation of JPY and delayed recovery of crude oil price. Second, expected rate of real GDP growth for FY2017 was improved from 0.1% to 1.7% (median). It was attributed to expected impacts of large fiscal stimulus as well as postponement of consumption tax hike.

It should be noted that the rest of the outlook remained broadly unchanged. It implies that at least the majority of MPM maintains confidence in resiliency of economic activities for the next few years, which would result in gradual but secular tightening of GDP gap. This is why the MPM reiterated that our economy could achieve 2% inflation sometime in FY2017. Majority of the board members understands that positive cycles of domestic expenditures, supported by elevated level of corporate profits and gradual increase in labor earnings, remain intact.

It should also be noted, however, many of the MPM members were cautious about downside risks, especially on inflation front. They saw the factors including uncertainties of global economy and international financial markets as well as considerable lag of time for improving inflation expectations could become potential sources.

Additional stimulus

Awareness of external risks were in fact the reason for the decision of additional stimulus today. First part of the policy statement explains that the board members were concerned about potential negative psychological impacts on firms and households by growing uncertainties about emerging economies and instabilities of international financial markets.

These lines of concerns appear to have guided the choice of policy instrument. As Governor Kuroda explained, the MPM intended to support the corporate activities by the increase in the amount of ETF purchase (from ¥3.3tn to ¥6.0tn) as well as the enhancement of fund provisioning operations in USD.

While such line of argument itself could seem to be reasonable, reporters at today's conference criticized that the policy decision was too modest. Moreover, some press reporters referred to Governor Kuroda's doctrine of policy making in a front-loading manner, and asked if it was modified. In reply, Governor Kuroda strongly denied such modification and reiterated the idea that the couple of measures were most appropriate to reduce the negative impacts of external risks.

Even if you are convinced the needs for the couple of measures, their transmission mechanism on inflation might still be unclear. Governor Kuroda answered to a few questions in this context by referring to his understandings that resilient domestic corporate activities supported by these measures would contribute to continuous tightening of GDP gap.

Another point of interest in today's policy decision was reinforced collaboration with the government. This line of debate was triggered by the discussion on "helicopter money" in earlier month. Moreover, in recent weeks, we noticed some comments by important figures of the cabinet, requesting the supports by the BOJ to a large fiscal stimulus to be announced shortly.

Governor Kuroda confirmed that the reason for additional stimulus was their concerns about the external risks, as reviewed above. Nevertheless, he explained that monetary policy should be a part of overall economic policy and therefore close communication is important. And he mentioned that QE and NIRP as the major part of QQE would prevent a side-effect of fiscal expansion by keeping long-term yields lower.

Comprehensive assessment

The last paragraph of today's policy statement stipulates that Governor instructed the staff to prepare deliberations for a comprehensive assessment of QQE at the next MPM in September. In fact, it attracted substantial attentions.

Interestingly, a number of press reporters suspected that this could be due to perceived limitations of QQE. As a background, it should be noted that there has been a renewed debate on the desirability of policy strategy of QQE, which have required the BOJ to achieve 2% inflation as soon as possible. Moreover, the discussion for exploring flexibility in achieving the target has been affected by those in overseas economies where a tough challenge to 2% inflation is shared.

Governor Kuroda, however, affirmed the idea that the BOJ would conduct such assessment with a view to achieving the inflation target at the earliest time. Moreover, he implied that the BOJ could rather enhance QQE with some new measures, according to a result of such assessments. At least a part of domestic market participants seem to share this line of thoughts in the afternoon session of our markets.

Including the declaration of such assessment of QQE in the direction of potential enhancement may have effectively prevented instabilities of domestic market due to a potential disappointment to a modest set of policy decision. Furthermore, such a kind of "pre-announcement" of additional stimulus could be a sign of divergence from "shock and awe" strategy in earlier phases of QQE.

From fundamental viewpoints, it is still not certain about the backgrounds of this assessment at this point of time. Governor Kuroda may like to secure the achievement of inflation target within his five year term. Alternatively, earlier achievement of the target could rather provide opportunity for introducing flexibility afterwards. All in all, a comprehensive assessment could provide hopes for variety of stakeholders of the BOJ with diversified views.

Author: Tetsuya Inoue
General Manager and Chief Researcher
Financial Technology and Market Research Department
Nomura Research Institute