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Towards a “revival” of Monetary Policy Meetings (MPMs)

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Executive Summary

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MPMs as a framework of collective decision making in the BOJ face challenges, since the gravity of policy making has shifted toward "collaboration" with the government. Nevertheless, MPMs could play some substantial roles. Possible area would be the discussion of economic and financial structures with a view to return to policy normality. Another area would be the discussion of financial stability, trying to minimize possible side-effects of unconventional policy.

Debate surrounds Monetary Policy Meetings

During several months since the BOJ announced its "Quantitative and Qualitative Easing (QQE)" program, the volume of news reports, commentary, and debate on the new regime has been tremendous. Much of the discussion has focused on the feasibility of the BOJ's inflation target, and by implication the Bank's large JGB purchases and supply of excess reserves. But at the same time, I am interested to find that a substantial amount of attention has focused on the framework of the BOJ's decision making – notably the Monetary Policy Meeting (MPM). The debate here can be broken down into several points.

First is inspired by the fact that the same Policy Board members who generally supported former Governor Shirakawa's monetary policy with unanimous decisions quickly signaled their approval for Mr. Kuroda's bold change in policy. Market participants and the media have been surprisingly critical of this change in stance. Inasmuch as it appeared to outside observers that Policy Board members had experienced a sudden change of heart, this criticism is worthy of consideration.

However, subsequently released minutes of Policy Board meetings suggest that if Board members' stance did change, it happened not when the new easing policy was unveiled on 4 April, but rather when the Bank adopted an inflation target under Mr. Shirakawa. As soon as that target was introduced, MPM participants naturally felt obliged to achieve the target and faced the task of deciding what sorts of policies should be implemented to achieve the target—which is why some Policy Board members proposed measures that anticipated some elements of QQE. In that sense, I think the criticism may have been excessive and corrected.

Second, there was considerable skepticism about whether MPM made a substantive contribution to the decision on quantitative and qualitative easing. Inasmuch as some Policy Board members had already proposed certain elements found in the new easing regime prior to the announcement, I think it is clear that MPM at least made a certain contribution.

That said, I think this criticism involves a more complicated aspect than the first one. It is difficult to reject the argument that, from the adoption of the inflation target to the unveiling of QQE, the government’s (or Prime Minister’s) intent was reflected more clearly than previous in BOJ policy. In other words, while the technical content of the new policy may have been designed and decided within and by the BOJ, it is not clear whether the center of decision-making gravity on QQE was found at the BOJ. I think critics are using this point to question the significance of MPM which by legislation should be the center of the gravity.

In the interest of defending Policy Board members, I would hasten to add that the central banks in many developed economies may already be experiencing similar problems, probably to a more severe degree. In fact, these major central banks were forced to implement policy in close conjunction with various government agencies, effectively coordinating all policy decisions with related government departments. This has been because these economies had overcome financial and fiscal crisis, and the policy measures by the central banks have been required to address somewhat broader issues than before. Broadly speaking, I think we can say that the center of policymaking gravity has shifted away from central banks to some extent since the global financial crisis, not only in Japan but also in the rest of the developed economies.

Third, an issue that has arisen more recently is the implications of the characteristics of QQE, which proves to be a strategy that seeks to emphasize the quantitative impact by a barrage of policy actions in a front-loading manner. From this perspective it is possible to derive a number of important implications for policy administration.

First of all, we now have a situation in which, in the event that the new easing regime does not have the desired effect or the external environment deteriorates, there will be little effect unless the BOJ unveils a policy having a similarly large (or larger) impact. That is why no fine-tuning of policy is planned, which sets it apart from Mr. Shirakawa’s Comprehensive Easing. At the same time, inasmuch as the policy tools being adopted are “bold” in terms of the amount of funds being supplied, the details of implementation have to be decided based on a dialogue with fiscal authorities and financial market participants, rather than the discussion within the BOJ.

That means that MPM participants will not only be freed from having to discuss and decide policy tools while under constant pressure to conduct additional easing (as was the case for a long time), but will no longer need to discuss and modify the details of asset purchases and excess reserves, which traditionally were key aspects of additional easing.

I do not think we should reject or try to unwind this tendency because it “undermines the significance of MPMs.” If one of the purposes of QQE is to make use of a quantitative impact—which is why this kind of policy is often referred to as a “bazooka”—to uproot deflation expectations, then a return to this kind of fine-tuned policy administration would undermine the very rationale for this policy approach. At the same time, I think few would object to the argument that close, day-to-day coordination between the BOJ and the private sector on asset purchases and excess reserves would lead to better performance, as it has proven to be true during these months.

New role for Monetary Policy Meetings

Should we then conclude, as the discussion above could suggest, that MPMs now have a reduced role and fewer opportunities to fulfill that role? I do not agree, and I believe that MPMs will be able to play a different role under QQE than they have traditionally.

One new role for meetings will be the discussion of economic and financial structure from a longer-term perspective. Inasmuch as policy decisions—even ordinary monetary policy decisions—are made based on a medium-term economic and price outlook of two to three years (taking into account the policy lag), I think MPM discussions have already been conducted within this timeframe. But the QQE regime contains a number of elements—including a large increase in the amount of funds being supplied and a sharp pick-up in the Bank’s JGB holdings—with the potential for a broad, long-term impact. On this point, I think it will be important for MPMs not to rush to conclusions and to engage in a thorough discussion of these issues, taking into account a variety of perspectives.

There is truth in the concerns voiced by some that discussing side effects and normalization so soon after the new easing regime was unveiled risks undermining the effort to uproot deflationary expectations. If so, the BOJ should not delve too deeply into these issues in the minutes and should keep such discussions private. That the FOMC minutes suggest from time to time that the Fed has engaged in longer-term debate on a specific topic should come as no surprise to the financial market professionals reading these reports. One notable example is the FOMC’s reviews of “Exit Strategy Principles” as evidenced by the minutes, which have paved the ways to “tapering” of the so-called “QE3”. Of course, such discussions should probably be carried out periodically since doing so at every meeting would place an unacceptable burden on the Board.

Discussing structural issues at MPMs from a longer-term perspective becomes even more important under Abenomics. First, the BOJ has an outstanding research expertise that is the equal of any government economic agency. I think that by sharing with the government the content of MPM discussions based on input received from the research staff could help enhance the third “arrow” of the government’s economic policy (the growth strategy). Too, an enhanced growth strategy would make it easier for the BOJ to achieve its inflation target in a form supported by improvements in the real economy.

A second area in which I think MPMs could make new contributions is in the discussion of financial stability. There is probably substantial overlap between such discussion and consideration of the longer-term structure of the economy as above. This could also include discussion of financial stability from a somewhat shorter temporal perspective. Needless to say, QQE contains aspects related to financial stability in ways other than increased purchases of risk assets. And if we are to take cross-border considerations into account, one subject for discussion might be the implications of increased capital flows to emerging economies resulting from large-scale monetary accommodation.

In my previous report discussing the “global standard” for central banks, I argued that the major central banks’ role in maintaining financial stability had expanded greatly since the financial crisis. However, I cannot help but think that this is related not only to the lessons of (and reaction to) the severe financial crisis but also to the stronger-than-usual connection between financial stability and the unconventional monetary policy adopted by central banks in most of the developed economies. If so, it would hardly be surprising if the BOJ—which has now adopted a policy that is both qualitatively and quantitatively on a par with those unveiled by the central banks of the US and Europe—came to the same conclusion.

Needless to say, discussions regarding financial stability must be handled even more delicately than talks about the side effects of QQE and the normalization of monetary policy. It may even be necessary to go a step further and exclude mention of the discussion in the published minutes or even call unofficial meetings to discuss the issue. Still, I think it is important that the BOJ discuss this topic, because the BOJ has an even greater presence in research and analysis on the financial system than on the real economy. Declaring that research findings should be utilized in MPMs would have real and positive implications for policymaking authorities as a whole, in my view.

Post-QQE outlook

If the "piecemeal approach" criticized by Mr. Kuroda at his 4 April press conference is one problem shared by many Japanese organizations, another is the inability to accurately and objectively forecast a post-crisis environment, whether the measures taken to address that crisis are successful or not. I would like to see objective, far-sighted, and confidential discussions by the members of the Policy Board at the BOJ led by Mr. Kuroda, with no need to worry about "transparency" or to reveal anything at present. It would be even better if such discussions were already taking place somewhere deep inside the BOJ.

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