BOJ's monetary policy decision: some thoughts

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Sober views

・The BOJ decided to maintain the current stance of monetary easing today. While some had hoped for additional easing, referring to the fact that a member of the policy board had proposed larger amount of increase in the asset purchase program at the previous meeting, majority of the markets priced in the "no action". Moreover, there has been a strong view that there could be another round of easing whenever appreciation of JPY rates accelerates for whatever reasons. In spite of such sober views, in my view, it would deserve the review of some aspects of today's decision.

Point 1: Tail risk

・Some of the domestic commentators have already claimed that it is inconsistent for the BOJ to keep their monetary policy unchanged despite the fact that the BOJ slightly downgraded its outlook of Japanese economy today. In fact, the BOJ's statement of monetary policy notes that our economy recovers at a more moderate pace (see the second paragraph of today's statement), and such evaluation was not seen at the previous cases. Moreover, it is by no means a trivial issue, because such downgrade is conducted only three weeks after its semi-annual review of the economic outlook.

・In my view, however, the BOJ's decision today would not be inconsistent from the central bank's point of view. You would like to recall that the BOJ decided to expand the scale of the asset purchase program at the previous meeting (three weeks ago), mostly because they are concerned about elevated uncertainties about downside risks. Put differently, the BOJ enhanced their monetary easing as an "insurance" for tail risks. Therefore, even if we are observing some signs of deteriorating overseas economic conditions, their negative impacts on our economy – especially in the area of production and exports – is expected to be taken care of by the policy action in the past.

Point 2: Financial condition

・At the recent cases of the monetary policy meeting, the BOJ has insisted that the conditions of Japan's financial markets have been the most accommodative amid the considerable stresses in global major markets.

・Their detailed description could be found in the semi-annual outlook of economy in October (see the section III); the indicators of both the money markets (Libor-OIS spread, for example) and of the credit markets (credit spreads over the government bonds, for example) remain stable and lower. Credit costs and non-performing-loan ratios of Japanese FIs have also been lower. As a result, issuing conditions of CPs and corporate bonds remain favorable, and liquidity positions of Japanese firms have been improving, strongly supported by stronger appetite for commercial lending by Japanese banks.

・Naturally, the BOJ insists that such accommodative conditions has been substantially enhanced and maintained by their "powerful monetary easing". The BOJ suggests that, in addition to monetary operations intended to lower longer-term rates, purchasing riskier assets including CPs, corporate bonds, ETFs and J-REITs have been contributing.

・Such claims are backed by some hard evidences, however, there remain some issues regarding the evaluation of financial conditions. Even if you could disregard uneven conditions for firms with different sizes, you could still raise some macro-economic issues. First, from the viewpoint of corporate borrowers, financial conditions should be evaluated in light of rate of return of investment. One of its most convenient measures is to compare long-term interest rates and potential growth rate, both in real terms. In fact, its chart is included in the BOJ's semi-annual outlook of economy. While the real rate of JGBs has been extremely low (approximately 0.7%), it appears to be higher than the estimated rate of potential growth rate (0.5%). In this respect, you could find more accommodative markets in major economies.

・Second, a financial condition index (FCI) usually covers stock markets and foreign exchange markets as well as the kinds of financial markets mentioned above. Although the global financial centers have been hit by considerable drops in stock prices in common, Japan has been one of the outliers that experienced substantial appreciation of its currency for years. Concrete discussion based on a FCI would be difficult due to technical problems of estimation of such index; nevertheless, Japanese firms would like to claim that our financial conditions have not been so accommodative, when taking into consideration of tightening effect of JPY's appreciation. Ironically, this line of thoughts leads to the market's shared view that the BOJ's next possible move will be triggered by the JPY's accelerated rise.

Point 3: Temporary and limited measures

・Retrospectively, the BOJ launched the asset purchase program when introducing their "Comprehensive Easing" framework. One reasonable hypothesis for the reason of its launch is that the BOJ intended to separate the set of new policy measures from the existing (and conventional) ones, as they are different in terms of intensions each other. If this would be the case, the idea has something common with the SMP by the ECB, as both of the central banks would like to see the new measures as "temporary and limited in amount".

・Despite such original idea, the asset purchase program has been expanded at several occasions. Since the last monetary policy meeting, its target amount is as large as ¥55tn. Furthermore, it would be worth noting that the target amount of asset purchases excluding short-term monetary operations already becomes ¥20tn, which is almost the same size as the annual amount of the existing operation of JGB purchase ("Rinban" operation). If the BOJ decide to increase its size further – and it would be highly probable because it is hard to expand the scale of short-term monetary operations due to their "chronic" under-subscriptions –, "temporary and limited in amount" measures would become long-lasting and dominant in scale among policy tools for the BOJ.

・This may only be a symbolic event; still, it strongly suggest that the BOJ as well as the major central banks would have to live in the world of "new normal" at least for the time being.

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