

Three issues:

Since the Bank of Japan decided to maintain the current policy stance on Tuesday this week, which made some disappointments especially among the overseas market players, there is a growing debate about the prospective policy actions at the next monetary policy meeting on April 27.

Its diversified opinions suggest that there remain the challenges for the BOJ in its communication with the markets. In this note, I raise three issues about the BOJ's policy strategy which could be relevant to the next move.

Issue 1: Improved economic outlook

At the latest MPM on April 11, the BOJ slightly upgraded their economic assessment, although it attracted little attention. While their views on the overseas major economies still remained cautious, the BOJ pointed out that the activities of our domestic economy modestly improved. Among all, they referred to the continuous improvements in private consumption and business investment, which they think brought about some signs of picking up in production.

Accordingly, from the viewpoint of economic fundamentals, it would rationally be argued that the BOJ is unlikely to decide additional easing at the next MPM. Because it is probable that the BOJ will maintain this relatively bullish outlook at the next MPM on April 27 which is only two weeks ahead.

The story, however, would not be so simple. Even at the time of the MPM on February 14, when the BOJ increased the amount of its JGB purchase by ¥10tn at the same time as the introduction of "Price stability goal", they referred to some signs of improvements of activities in both overseas and domestic economies. And they explained the reason for the additional monetary stimulus was to "further support recent positive developments".

All in all, it would be hard to expect the next move by the BOJ solely on the basis of our economic development and/or its BOJ's assessments. And it could be argued that we may need to pay more attention to longer-term factors in order to think about the monetary policy conducts for the time being.

Issues 2: Optimal policy choices against deflation

As I discussed in the previous "Note" in March, it may be hard for the market to understand what kind of reasons the BOJ thinks most important for our persistent deflation.

At the latest MPM on March 13, the BOJ emphasized its long-lasting idea that the deflation should be overcome by the efforts for faster economic growth as well as monetary stimulus. This was consistent with their choice of enhancing the Growth-Supporting Funding Facility (GSFF) as the policy measure at that time.

When the BOJ introduced the "goal" on February 14, however, the markets thought that the BOJ finally accepted the claim by their opponents that the deflation has been the monetary phenomenon and it should be addressed by further expansion of fund provision. From their viewpoints, this must be the reason why the BOJ decided to expand the scale of JGB purchase by ¥10tn.

While the BOJ seems to be aware of this issue of policy communication with the market participants and Governor Shirakawa started to insist that the BOJ has been conducting these two sets of policy measures as "Policy package",

their efforts appears to have been not so successful. Some market participants suspect that changes in policy choices over these months may imply that the internal balance of power of the opinion at the BOJ has gradually returned to its original position. And others like to claim that the BOJ may address its quantitative policy to prevent the appreciation of Japanese yen, while it would use its structural policy to battle against the persistent deflation.

In any case, it is highly desirable for the BOJ and the markets have coherent views at least with regard to the role of the central bank in the battle against deflation. If we lack such convergence in the views until April 27, the BOJ's policy decision could trigger unnecessary volatilities due to miscommunication of the policy intension and misguided disappointments in the markets.

Issue 3: Inflation outlook under the "goal"

The BOJ will review its semi-annual outlook at the next MPM on April 27. While the BOJ could rationally be expected to make any policy decision based on the revised outlook, it would not be the case as I discussed in the first session above. Nevertheless, the review deserves much attention.

Under the framework of "Understanding of price stability" before February 14 this year, the BOJ announced the range of expectation by the members of the policy board. Each member is in principle required to estimate the inflation rate based on the outlook of policy rates implied in the markets.

In contrast, it would still be uncertain whether such structure of inflation outlook should remain unchanged under the new framework of "Price stability goal". For example, could the BOJ announce revised inflation outlook with the range of expectation of inflation in FY 2013 less than 1%, which the BOJ declared its goal for the time being? This could raise the issue of viability of the new "goal".

In addition to the diversified views whether the "goal" has something closer the "formal" targeting, the uncertainty about the time frame of reaching the "goal" is the pivotal factor. Specifying its time frame, however, would be a hardest task for the BOJ. Because the BOJ would think that our deflation should be overcome by the acceleration of economic growth, which would doubtlessly take lengthy period of time.

Thus, the issue of inflation outlook under the regime would bring us again to the issue of the cause of deflation. With this regard, I am concerned that there are still the polar views of our deflation in Japan, and members of the respective lines of thoughts appear to be sober about exchanging views.

We should revisit the debate on the causes of our deflation in the end, which would also contribute to more efficient policy conducts in overseas economies.

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