Notes on Financial Markets Vol.125

Press conference by Governor Kuroda: Yield curve control

September 21, 2016

Introduction

The MPM released the results of its comprehensive assessment of QQE today. Interestingly, reactions in our markets were rather muted, in spite of its fundamental modification of policy strategy. Probably, the markets had difficulties in digesting it, because the BOJ added so many variables some of the relationships were complicated.

In light of such conditions, let me focus on the ideas and implications of the yield curve control.

Backgrounds

According to Governor Kuroda's speech on September 5, fundamental background of comprehensive assessment is the failure of achieving the inflation target in spite of extremely large scale monetary stimulus. While he claimed that large part of its causes have been "exogenous", he confirmed that the QQE has not been effective enough.

From the viewpoint of policy instrument, the focus of review has apparently been put on JGB purchase and NIRP. Regarding JGB purchase, there has been a growing concerns in the markets about its sustainability, although the BOJ would not like to share such view for the obvious reason.

One easiest idea to overcome the boundary of JGB purchase is changing its operational target from quantity to interest rate. Under such modified framework, the BOJ could claim the monetary stimulus would still be effective as far as the BOJ could cause downward pressure on yields, even if we would observe under-subscriptions of JGB purchase operations.

Ideas

Introduction of "Yield curve control (YCC)" as the MPM decides today is fundamentally the shift of operational target from quantity to interest rate. Specifically, the BOJ announced that 0bp as the yield of 10YJGB is the initial target. Because the BOJ now targets long-term yield, they could no longer maintain the quantitative target in a strict manner. In fact, Governor Kuroda admitted that actual amount of purchase of JGB could be larger or smaller than the previous target.

While this is the core element, there are several additional elements that may have made "YCC" complicated. First, Governor Kuroda explained at the press conference, all the BOJ will try to anchor will be O/N rate (at -10bp for the moment) and 10YJGB rate (at 0bp). Second and nevertheless, the MPM introduced a new fixed rate JGB purchase operation (with pivotal points of the yield curve). Third, the policy statement indicates that the BOJ would maintain the current pace of JGB purchase at ¥80tn increase on annual basis in terms of the outstanding amount of JGB holdings.

In light of these additional elements, press reporters raised several issues of the practice of YCC. Firstly, number of press reporters asked Governor Kuroda how tight the control would be. Governor Kuroda explained that it has become a shared practice among major central banks to intend to have more direct impact on long-term yields under UMP. He also implied that control of the yield of 10YJGB would not be so tight, unless there are strong pressures in either direction. Moreover, Governor Kuroda denied the intension of control of whole range of yield curve, because it is not possible or desirable.

Secondly, a few press reporters asked the reason why the BOJ maintains the quantitative target of JGB purchase under the interest rate targeting. While Governor Kuroda avoided to answer this question in an outright manner, there is an understanding in our market that this was a result of compromise within the policy board. In addition, as the detailed analysis by the BOJ for this comprehensive assessment suggests that quantitative aspects of QQE was estimated to be effective at least during its earlier phase.

Thirdly, a few press reporters asked whether the BOJ would like to steepen the JGB yield curve through "YCC". Readers may like to remember that substantial flattening of JGB yield curve has been the source of criticism and concerns about NIRP, because it could hurt the function of credit creation by the financial intermediaries due to depressing interest margins.

At the press conference, he affirmed that the BOJ should take into account of side effects of flat yield curve including the potential negative impacts on credit creation. Nevertheless, he expressed skeptic views on the idea of steepening the yield curve by way of "YCC", mainly because it could rather imply tightening the financial conditions. I share the skepticism about intentional steepening of the yield curve, mostly because its flattening has fundamental reasons including our extremely low expectation of growth and inflation from long-term perspectives.

Implications

As discussed above, "YCC" would not be so extraordinary as the term suggests, as far as it would be the interest rate guidance at only two points in the yield curve with a light touch. Nevertheless, "YCC" makes a step forward on the idea of affecting long-term rates in a direct manner, which has been common among major central banks.

In the context of QQE, introduction of "YCC" means the shift of its focus from quantity to interest rate both in terms of its operation and transmission, although there remains some elements of quantity.

Among the challenges of "YCC", I would like to point out the following two issues. First one is how the BOJ could communicate with the market about the magnitude of monetary easing. This would not be an issue for the moment, because the BOJ effectively endorsed the current rate of 10YJGB as target. When the BOJ would like to enhance its easing, however, they may need to show the "distance" between the new target and some "equilibrium" rate.

Second one is not an imminent challenge, but could be an issue in the long run. If the BOJ shows the ability to control the yield of 10YJGB in an effective manner, it could pave the way to uncomfortable deals in our economy where the markets would not share the confidence in fiscal consolidation from long-term perspectives.

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