Notes on Financial Markets Vol.127

Press conference by Governor Kuroda : Reaction Function

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Introduction

The BOJ's new outlook not only made downward revision of inflation forecast, but also postponed the expected time of achieving its inflation target to sometime in FY2018. Interestingly, reactions in domestic financial markets were muted. With this respect, the BOJ accomplished the task of "comprehensive review" of the QQE. Nevertheless, this would not be the end of story of the QQE.

Outlook of economy and prices

Due to editorial revision of the BOJ's new outlook, including the change from time-series analysis to cross-sectional one, it would not be easy for readers to identify the differences of their assessments from the previous case in July.

Their main messages, however, are rather simple. While the MPM maintained their economic forecast, they made slight downward revision of inflation forecast. In fact, their current forecast of real GDP growth rates from FY2017 to FY2018 are +1.3% and +0.9%, exactly the same as those at the previous outlook in July. Their current forecast of core CPI inflation rates from FY2017 to FY2018 are +1.5% and +1.7%, lower by 0.2% points respectively.

The MPM confirmed its central scenario of economy that virtuous cycle from income/profit to expenditure will continue to function. Moreover, they highlighted the positive spillovers from fiscal stimulus package as well as growing investments to prepare for Olympic Games in Tokyo in 2020. They also affirmed their scenario of a gradual recovery of exports.

As the backgrounds for such constructive views, the MPM referred to extremely easing financial conditions as well as to gradual improvement of natural rate of interest supported by achievements of the structural reforms. This line of argument would be a sign of the shift of gyration from "quantity" to "interest rate" that results in communicating the appropriateness of the policy rate in light of these two important factors.

The MPM also confirmed its central scenario of inflation that narrowing GDP gap and improving long-term inflation expectation could gradually accelerate the rate of inflation, after it would crawl around 0% for the time being. They, however, admitted its probable delay. They raised some reasons including 1) continuous effects of adaptive formation of inflation expectation due to actual low rate of inflation, 2) sluggish improvement of GDP gap, and 3) carried-over effect from appreciation of JPY in previous months.

In terms of inflation expectations, distinguishing adaptive formation from forward-looking formation would be another by-products of "comprehensive review". It should be noted, however, assumption of crude oil prices for the outlook substantially changed due to shifting expectations implied in crude oil futures. Gradual pace of recovery of crude oil prices would lack the strength for driving inflation rate, although it could still contribute to exit from negative rate of inflation.

All in all, such assumption and its implication would be consistent with the current assessment that narrowing GDP gap and improving long-term inflation expectation would be the only factors that could accelerate the actual rate of inflation. If the viability of latter factor above is uncertain, we could have internal risk to prevent the achievement of inflation target.

Issues of FY2018

As discussed in "Introduction", domestic financial markets at least perceived the combination of the maintenance of monetary stimulus and of the postponement of expected time of achieving the target as a new "rule of game".

It may be the product of learning effects by the previous cases. In fact, according to a press report, such combination of events already occurred four times under the QQE. Nevertheless, high ranking officials of the BOJ including Governor Kuroda implied no policy actions in advance at various occasions such as international financial forum and parliamentary sessions. These kind of actions apparently confirmed the modification of communication policy, which would be the third pillar of "comprehensive review".

In contrast to favorable sentiment in the market, the atmosphere of today's press conference was not so friendly. In fact, roughly half of the questions referred to the probability that Governor Kuroda could not observe 2% inflation before his term ends in April 2018. Furthermore, reporters asked Governor Kuroda about the reasons, the views, and the responsibility for the failure of achieving the inflation target.

In reply, Governor Kuroda reaffirmed that the weakness of consumption after consumption tax hike, the appreciation of JPY due to instability of international financial markets, and the sharp fall in crude oil prices have been the downward drivers of inflation rate. He also insisted that conducting strong monetary stimulus under the QQE has been his mission. Interestingly, however, Governor Kuroda admitted that it was a pity not to achieve the inflation target.

All in all, the discussion at today's conference had a flavor of "comprehensive review". In fact, press reporters focused on some technical features of the yield curve control and the overshoot commitment of inflation at the previous conference. In contrast, reporters could now afford to consider "comprehensive review" from fundamental viewpoints.

Press reporters would be interested in the relationship between Governor Kuroda's term and achievement of inflation target. It would be all the more true, because Governor Kuroda introduced the QQE in a "non-linear" manner within the history of monetary policy by the BOJ. At the same time, the modified QQE since "comprehensive review" may have become closer to conventional policy both in terms policy instruments and policy strategy.

If such modification is well received by the markets and the public, it would be less probable that next Governor (regardless of Mr. Kuroda's renewal of terms) would have less motivation to change the framework of monetary policy. Then it would be less important to discuss the relationship between Governor Kuroda's term and achievement of inflation target at all.

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