

## Introduction

The MPM of the BOJ made modest upgrading of their assessment of domestic economy. Moreover, Governor Kuroda suggested that this was not due to the prospects of positive spillover of economic policy by the new administration in the US, but to the diminishing negative factors both domestic and overseas. It should also be noted that a number of reporters raised the issues of reaction function with regard to the yield curve control of 10Y JGB yield.

## Assessment of economy and prices

The MPM made a positive revision of their assessment of our economy. While its magnitude was modest, its area was broad-based. In fact, the policy statement pointed out the gradual recovery of exports thanks to the stabilization of emerging economies, resulting in the disappearance of some weakness of industrial production. It also referred to the improvement in the corporate sentiment evidenced by the most recent TANKAN survey. Moreover, it confirmed the recovery of private consumption from a temporary drop in earlier months.

Readers may like to note that all of these reasons were matters of the past. In fact, Governor Kuroda implied that the members of the policy board would not have taken into account of the positive prospects of spillover effects by economic policy by the forthcoming administration in the US.

Like the case of Chair Yellen's press conference, reporters would expect that the central bank could become all the more bullish, if the new administration would conduct a set of "pro-growth" economic policy as the market expects. Governor Kuroda, however, was somewhat cautious about this scenario, reminding of the uncertainties of global financial markets.

The reason why the MPM did not make upward revision of inflation outlook would also be the MPM's cautiousness about such uncertainties. Governor Kuroda affirmed that there are broad range of factors that determine the rate of inflation, while the recent depreciation of JPY could provide some supports to the inflation outlook to some extent.

## Management of the yield curve control

Most interesting part of the press conference today was the discussion on this topic. Readers may like to remember that there has been a growing discussion in our market, in light of the fact that 10Y JGB yield has crawling slightly above the BOJ's target (0%), and the BOJ increased the size of 10Y JGB purchase operations in response.

Some reporters asked if the BOJ could raise the target rate if and when upward pressure of 10Y JGB yield would strengthen. In reply, Governor Kuroda explained that the BOJ conducted the yield curve control (YCC) as part of the QQE whose purpose is achieving the 2% inflation target. He also emphasized that the MPM would review the appropriateness of the target level at its every meeting in the context of the purpose of monetary policy.

Furthermore, Governor Kuroda mentioned that the BOJ would not alter the target level of 10Y JGB yield as far as its upward pressure would be largely generated in overseas financial markets. An important implication of this comment is Governor Kuroda's view of the reasons of recent gradual increase in 10Y JGB yield.

As follow-up and interesting questions by some reporters were about the BOJ's reaction to possible acceleration of JPY depreciation. According to their views (which would be shared with the markets), successful management of the YCC may have been playing a significant role for recent depreciation of JPY by way of increasing yield spreads between the US and Japan.

In reply, Governor Kuroda reiterated that the yield spreads would not be the only factor to affect JPY rates. Moreover, he mentioned that the recent level of JPY rates would be "no surprise" and he understood that it has only returned to the level observed in early months of this year.

As a matter of fact, elevated concerns about emerging economies in January and heightened uncertainties after the Brexit vote in late June caused substantial appreciation of JPY and severe drop of our stock prices, resulting in the considerable deterioration of corporate and consumer sentiment.

In any case, press reporters and our domestic markets would share the view that the BOJ could face a challenge if our trading partners would start to criticize the accelerated pace of JPY depreciation, and to argue that the YCC would be the important driver.

Another important line of discussion is the BOJ's management of the YCC when we would observe upward pressures of 10Y JGB yield thanks to the improvement of our domestic economic prospects. Although some reporters raised this important issue, Governor Kuroda effectively avoided to answer to them, implying it would be too early to discuss.

Nevertheless, this issue could attract a growing debate if the improved sentiment of corporate managers could generate virtuous circle in our economy from corporate profits to business investment and private consumption. While the initial trigger would be the increase in external demand by a set of "pro-growth" economic policy by the new administration in the US, we could observe domestically oriented growth in the end.

In principle, the BOJ could raise the target level of 10Y JGB yield. In practice, however, it would not be so straightforward.

First, in setting the target level of 10Y JGB yield, the MPM might have added some flavor of "forward guidance". If this would be the case, frequent revision of the target would not be consistent with the original intension.

Second, it would be technically difficult for the MPM to conduct a "fine-tuning" of the target level of 10Y JGB yield. Because of this limitation, the reaction function of the MPM in adjusting the target level would not be so sensitive as some observers would expect.

**Author: Tetsuya Inoue**  
**General Manager and Chief Researcher**  
**Financial Technology and Market Research Department**  
**Nomura Research Institute**

This note is intended solely for informational purposes and should not be construed as investment advice. The author does not guarantee the accuracy or completeness of the information contained. Opinions in this note are those of the author and do not represent the views of Nomura Research Institute or Financial Technology and Market Research Department. This note is exclusively for the personal use of those receiving it directly from the author.