

Introduction

Summary of opinions released today indicates that the focus of discussion at the June MPM was future strategy of the QQE given we are still distant from achieving the inflation target. While the MPM may like to send a coherent message with this regard, the audience could identify some of their points of concerns.

In light of the features of the summary this time, I will only highlight the discussion on monetary policy in this Notes.

Inflation target

Readers may be aware that there has been a growing debate in our markets whether the BOJ should maintain the current framework of monetary policy.

From the fundamental perspectives, the QQE would not be so effective where adaptive expectation of inflation is dominant. Against this line of thought, there are some opinions in the summary arguing that the significance of the QQE remains intact.

One opinion claims that most effective way to achieve the inflation target is to keep reducing the output gap. Other opinion also suggests the patience in light of structural factors including formation of inflation expectation. Moreover, another opinion insists that the BOJ should maintain the current monetary policy with the aim of completely overcoming deflation while fostering people's better understanding of the 2% inflation target.

If you agree that anchoring the inflation expectation at 2% is absolute necessary for our economy, it would not be reasonable to suspend or alter the QQE fundamentally at this stage. Nevertheless, the markets may still wonder whether there would be alternative measures that would be more sustainable. I will shortly return to this issue.

Considering the frustration by the FRB and the ECB facing the lack of upward momentum of inflation, discussion on the viability of 2% target would also be interesting. While one proposes the review of the target, other opinion is consistent with the official view of the BOJ, confirming the maintenance of 2% target due to reasons both technical (i.e. upward bias and rooms for policy response) and fundamental (i.e. global standard).

In any case, the markets seem to believe that any significant decision on the inflation target by the BOJ would be reactive to potential policy actions by major central banks due to the obvious reason.

Normalization of QQE

Because we are still distant from 2% inflation, it is highly uncertain when the BOJ could exit from the QQE, as one opinion in the summary mentions. Nevertheless, there has been a growing discussion in our markets on the normalization of monetary policy, based on either technical and fundamental line of thought.

Regarding the technical aspects, focus of attention is sustainability of JGB purchase at the pace committed by the BOJ. In fact, one opinion suggests that the BOJ should formerly reduce the pace of annual increase. Readers may like to note, however, this opinion is not intended to launch

“stealth” normalization, rather to regain sustainability of the JGB purchase. Moreover, Governor Kuroda admitted at the most recent press conference that the actual amount of JGB purchase would become “endogenous” under the framework of the yield curve control (YCC).

Therefore, the markets appear to think that the BOJ could alter the commitment of pace of increase in JGB holdings as far as the BOJ maintain control over JGB yields according to the YCC. Remaining uncertainty is its timing. The BOJ would be very cautious about minimizing unfavorable reactions by the markets.

Concerning the fundamental aspects of policy normalization, there has been a growing debate in the markets and the parliament about potential losses from holding significant amount of JGBs.

Readers may wonder its backgrounds in our context. It might be too early when we are still distant from achieving the inflation target. Alternatively, it might be too late, because we could already foresee the issue when the BOJ launched the QQE in the spring of 2013.

While I would not have a definitive answer, some observers may become skeptic about the balance of effects and costs of the QQE which were maintained for longer period than previously thoughts. Moreover, as one opinion in the summary refers, improvement of economic activity may have provided the opportunity to review the QQE.

With this respect, one opinion claims the idea that the financial situations of a central bank would only be a factor that underpin the credibility of a currency, and argues that it would rather depend on the credibility of the country as a whole and is determined by several aspects.

I think that large part of the markets would agree with this general principle. At the same time, however, some market participants might be concerned that potential loss by the BOJ could trigger the issue of credibility of a currency, in light of existing factors including fiscal consolidation.

From the viewpoint of the BOJ, therefore, it would make sense to be accountable for its thinking on monetary policy management, rather than disclosing the precise result of loss simulation. As one opinion suggests, it could avoid raising exaggerated concerns in the markets.

Along this line of thought, one opinion in the summary insisting the fundamental achievements of the QQE so far, including the increases in tax receipts, would be an interesting approach. While some of the alleged benefits could be a target of debate, such approach could rationalize the understanding of the balance of benefits and costs of the QQE in the end.

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