Notes on Financial Markets Vol.142

Press Conference by Governor Kuroda—All about the YCC

December 21, 2017

Introduction

MPM of the BOJ decided to keep the current monetary easing unchanged. And at the press conference today, large part of the discussion was regarding the possibility of modifying the target rates under the yield curve control (YCC). It was not a surprise to domestic observers, because, since the last MPM in October, both Governor Kuroda and Deputy Governor Nakaso raised the issue of side-effects by maintaining extremely low interest rate environment.

Discussion on side-effects

Interestingly, some of the press reporters asked about the side effects by referring to the problem of low profits by our regional banks. In fact, the recent issue of Financial System Report (FSR) by the BOJ reinforced the messages to the managers of these banks about long-term implications of low profitability. (For your information, the author of the Notes had an opportunity to ask a question to Governor Kuroda on this issue at a speech event several weeks ago).

While Governor Kuroda confirmed that it could be the case from theoretical viewpoints, he denied that it is an imminent concern in our financial system. Governor Kuroda pointed out that Japanese banks including regional banks maintain solid capital positions, which would support their resiliencies against external shocks. Moreover, he insisted that the banks maintain strong appetite for domestic lending, which contradicts the implication of the discussion on “reversal rates”.

As an chapter in the recent issue of FSR suggested, Governor Kuroda emphasized that the major reasons for low profits by regional banks would rather be structural. They would include the lack of diversification of business models and the overcapacity of branches and human resources in light of rapidly changing demographics of our society. Governor Kuroda explained that these would lead to excessive competition among banks, resulting in low profits.

While this line of argument appears reasonable and persuasive, there still remain a few open issues on this topic. First, as recent discussions in international financial community on “low for long” suggest, negative effects on financial intermediation by extremely low yields could grow in a cumulative manner. According to this view, side effect could become disproportionate to positive effects of monetary easing, even though it is negligible for the time being.

Second, whether such side effects could have systemic implications is still uncertain. It could be possible that orderly exits of weak banks would not destabilize our financial system, and survivors and/or new entrants could replace the function of financial intermediation. Alternatively, deterioration of financial intermediation in a collective and simultaneous manner could pose threat to our financial system and economic activities. It seems that there would not be a consensus view, and in any case it could crucially depend on design and practice of financial supervision.

Flexibility of target rates

As follow-up of the above discussion, a number of the press reporters asked whether the BOJ is ready to adjust the target rates under the YCC.

In reply, Governor Kuroda confirmed that the current target rates are optimal in light of economic conditions, inflation rates and state of financial intermediation, and denied any needs to modify them. While this line of argument is consistent with the discussion on the side effects above, domestic observers may feel slight change of tone from a series of comments by Governor Kuroda in the intermeeting period since October MPM.

Its reason is uncertain, because none of the press reporters raised this issue today. Nevertheless, we need to recall the communication by Governor Kuroda and Deputy Governor Nakaso during these weeks, on the one hand. On the other hand, the BOJ could have difficulties in pursuing the inflation target if there emerges expectation of “policy normalization” at this early stage.

In any case, for the time being, all the BOJ would do with the YCC could be one-off fine-tuning of target rates with a view to minimize the side-effects, which would rather enhance the sustainability of monetary easing in pursuit for the inflation target. Under these conditions, it could makes sense for the BOJ to conduct communication policy on a very fine balance.

It should also be noted that, at the press conference today, Governor Kuroda insisted the flexibility of the target rates in the future. He affirmed that the optimality of the target rates will be checked at every MPM, taking into account of economic conditions, inflation rates and state of financial intermediation. Moreover, he explained that there remains the possibilities of modifying the target rates in both upward and downward directions.

An opposing vote

Mr. Kataoka, a member of the policy board voted against the policy statement again. According to the footnotes of the statement, he proposed the increase in JGB purchase in order to decrease in long-term yields. Moreover, he suggested to add the commitment to enhance monetary easing if the expected time of achieving the inflation target is postponed due to domestic economic fundamentals.

Because none of the reporters raised this issue at the press conference today, we need to wait for releases of “main opinions” or minutes of the MPM today in order to understand Mr. Kataoka’s discussion behind such proposals.

Nevertheless, his fundamental line of thoughts seems to be consistent with his previous opposing vote at the October MPM; the BOJ should do every thing in order to achieve the inflation target as soon as possible. Readers could argue against his idea in light of the discussion on the side-effects, or could agree with his idea, talking account of the downside risk factors in FY2019 claimed by Mr. Kataoka.

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