Notes on Financial Markets Vol.126

Summary of Opinions at September MPM of BOJ: Paradigm Shift

September 30, 2016

Introduction

The BOJ released Summary of Opinion at September MPM when they conducted the comprehensive review of the QQE and decided the modification of its framework. While the summary contained few unexpected issues, it implied that the consensus of opinions at the MPM might not be as strong as the voting results suggested.

Let me discuss some of the issues that could have implications for policy conducts in coming months.

Comprehensive review

The summary explained the several lines of argument for positive evaluation of the QQE so far. They insisted that the QQE achieved the economic condition without deflation, and confirmed the needs to enhance the forward looking formation of inflation expectation in light of our expectation in an adaptive manner. Not surprisingly, however, the summary also suggested the diversified views with regard to the short-term effectiveness of expansion of monetary base on inflation expectation.

It should be noted that the summary did not deal with the role of foreign exchange rate in inflation expectation in a direct manner. While the outside observers could agree with its significance almost unanimously, it would be hard for the BOJ to raise this issue. In fact, Governor Kuroda insisted at the press conference just after September MPM that foreign exchange policy is the matter of the MOF.

Concerning the NIRP, the summary explained its effectiveness as monetary stimulus through lowering the position of yield curve and suggested its side-effects on financial intermediation, as was discussed by Governor Kuroda at his recent speech. Nevertheless, the summary also suggested that there were non-negligible differences with regards to the desirable weights of considerations of such side-effects.

On the one hand, an opinion claimed the soundness of financial institutions would be crucial to maintain stability of the global financial system. On the other hand, another opinion required proper balance between the effects and side-effects. Yet other opinion claimed that better economic conditions by virtue of the NIRP could finally improve business conditions for financial institutions.

All in all, diversification of the views on side-effects of the NIRP could have implications for potential complimentary actions when and if the BOJ would need to enhance it.

Overview of QQE with yield curve control

In terms of the overview of the modified framework of the QQE, the summary explained the needs to enhance its resiliencies due to longer than expected battle to achieve inflation target. Moreover, it also insisted the desirability of enhancing its flexibility in light of the effects and side-effects as discussed above.

It is also interesting to note that an opinion confirmed the consistency of the QQE before and after its modification, while it expressed supports for the modification as a “paradigm shift”. This kind of ambivalent view would imply that the modification of the QQE’s framework this time might be the product of compromise of persistent diversified ideas of the QQE toward achieving the inflation target.

It is also important to note that the summary included several lines of fundamental views on the side-effects of the NIRP. According to them, lowering yields and depressing margins have largely been due to a number of fundamental factors including lower natural rates, long-term low inflation and excess savings of corporate sector. They further claimed that coordinated efforts by both private and public sectors would be required to restore natural rate, which could normalize the shape of the yield curve in the end.

It seems to me that this line of thought could attract broad range of supports from financial markets and non-financial corporations. The BOJ would then need to explore the remaining effective mechanisms of policy transmission and seek supports by public and private sectors in focusing their efforts on these specific mechanisms

Pillars of QQE with yield curve control

The summary explained that the experience of affecting the shape of yield curve throughout the QQE have led the MPM to introduce the idea of yield curve control (YCC). It further emphasized the benefits of its resiliency and flexibility. Moreover, it should be noted that it claimed the importance of explaining the nature of fluctuation of the amount of JGB purchase ex post that would not have policy implication at all.

Readers may like to note that the summary included some lines of cautious views. Namely, an opinion referred to the concerns about fixing long-term yields at extremely low level, which could worsen the function of financial intermediation. Another opinion pointed out the potential expansion of the scale of asset purchase when there would be upward pressures on the yields. If it would be the case, YCC could not contribute to enhance resiliency of the QQE.

With regard to the first point above, the BOJ would be required to show the optimality of its target yield of 10YJGB. In light of the concern, it would be reasonable for the BOJ to announce that they conduct regular review of the target at every MPM. Nevertheless, it would be a hard task for the BOJ to conduct “fine-tuning” of the target of 10YJGB from practical point of view. In any case, the BOJ and the market should learn by doing the practice of optimal control.

In contrast, the summary contained only a few lines of opinions on the policy commitment that allows overshooting of the actual rate of inflation above the target. While it explained the skeptic view of the new commitment at least for the moment (when actual rate of inflation would still be low), it also included the claim that future expansion of monetary base implied by this new commitment would still be important to improve inflation expectations. This is another sign of compromise of the fundamental idea of the modification of the QQE, which could have made the new framework harder to understand.

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