Notes on Financial Markets Vol.123

Press conference by Governor Kuroda—Medium-term implication

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Introduction

Rather than the policy decision by the BOJ to maintain the current policy package of QQE, a jump in the value of JPY today attracted attention by broad range of observers. While one of its major reasons could be diminishing after the "event", accumulated impact of JPY's appreciation could have medium-term implications on our economy and policy strategy.

Assessment of economy

Unlike the case of FOMC, June meeting is not a time for quarterly revision of its outlook for the MPM. Even if taking into account of this fact, points of modification of the assessment of our economy by the MPM were minimal. They upgraded the view on housing investment to some extent, and started to refer to the near-term prospects of negative rate of inflation (like the case of euro-area).

In contrast, most important point of revision of the policy statement today was the reference to some risks of instabilities of international financial markets, which could undermine the sentiment of economic agents and delay the removal of our deflationary mindset. As Governor Kuroda implied at the press conference (less clearly than Chair Yellen, however), one important source of instability is the heightened uncertainties of "Brexit".

Crisis measures versus additional stimulus

In our context, such stress in financial markets has most likely affected foreign exchange rates coupled with long-term interest rates. In reply to questions by some reporters on potential tools of the policy to calm the pressures in the markets, Governor Kuroda implied some kind of coordinated actions by major central banks. While he did not specify the measure, he confirmed several times that the BOJ has been frequently exchanging information with overseas central banks.

Coupling some crisis measures with financial stress that is seemingly transitory would be reasonable. Moreover, we could have confidence in major central banks in light of their experiences during the global financial crisis. Nevertheless, the markets could still wonder whether executing the crisis measures would be sufficient or not for our case, because they have noticed other sets of reasons for the appreciation of JPY from medium-term perspectives.

One of the reasons would be the changing prospects of monetary policy across the Pacific. On the one hand, the markets may perceive that the FOMC would be very cautious in making the next step, after having seen the SEP and dot charts today. On the other hand, they may understand that the MPM's reaction function would be muted since the April meeting, when the BOJ made no action with delaying the expected timing of 2% inflation again.

If this is the case, upward pressures on JPY might not be temporary and could remain intact regardless of the result of "Brexit" vote. And as a result, significance of higher value of JPY would change to issues of fundamental economy from that of financial stability. The BOJ would then consider additional stimulus to prevent the downward pressures on inflation and economic activities caused by upward movement of JPY. In fact, Governor Kuroda expressed some voices of concerns about its negative impacts on our economy, and reiterated his commitment to conduct monetary stimulus without hesitation when necessary.

Policy strategy

Additional stimulus against the appreciation of JPY could further complicates the BOJ's strategy of monetary policy.

First point is the choice of easing measures. We have noticed gradually growing debate that the BOJ should shift the gyration from JGB purchase to NIRP. There is a number of reasons for this line of argument, including potentially gradual disappearance of "price elastic sellers" of JGB against the BOJ's purchase operations. Moreover, as discussed at the press conference today, there is a recently emerged reason; potential concerns about monetization in light of another postponement of consumption tax rate hike.

But on the other hand, skepticism about NIRP seems to remain intact. In addition to skepticism by broad range of financial industries, criticism by households (especially among elder people) is still vocal. It is at least necessary for the BOJ to make some time for financial business to adjust their practices and systems, before strengthening their NIRP.

Second and more important point is the medium-term strategy. As discussed in the previous issues of this Notes, our general public have been losing interests in pursuing 2%inflation as soon as possible. This would not be the faults of QQE, because skepticism of 2% inflation has been largely due to lack of improvement of nominal earnings. Under such condition, acceleration in inflation only reduces real purchasing power of households.

In light of these conditions, flexibility of achieving the target (especially in terms of its timeframe) would be a reasonable idea that could be appreciated by our general public. Furthermore, it would be an appropriate timing to make its gradual modification as far as our fundamental economy goes along the modestly bullish economic outlook.

Rapid appreciation of JPY, however, would derail the potential idea of gradual modification of monetary policy strategy on inflation target front. If the foreign exchange market have already noticed some signs of such modification and make it as a catalyst for appreciation of JPY, a hurdle for such modification would be higher than previously expected.

JGB yield curve

One of the conundrum of the BOJ's NIRP (as well as its source of criticism by financial industry) is substantial flattening of JGB's yield curve since the introduction of NIRP. While there has been an active debate over its backgrounds, there would not be a decisive hypothesis yet. With this regard, Governor Kuroda implied today that there might be diversified views within the BOJ. In order to step forward NIRP when necessary, deeper understanding of its backgrounds would be a non-negligible condition.

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