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Summary of Opinions at October MPM—Allocation of policy tools

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Introduction

Summary of Opinions at the Monetary Policy Meeting (MPM) in October suggests that the focus of the discussion was the prospects of overseas economies and the implications of side-effects on financial intermediation.

Assessment of economy and prices

Members of the MPM seemed to have a consensus view that the domestic economic activities are expanding moderately.

One comment welcomed the relatively bullish views of firms implied by the results of the most recent TANKAN survey. Moreover, another comment confirmed the view that the negative impacts by a series of natural disasters from macro-economic viewpoint are expected to be temporary.

In contrast, members presented the mixed views regarding the prospects of overseas economies. On the one hand, a couple of comments referred to the uncertainties about the trade conflicts between the US and China. Another one pointed out that the growing risks surrounding the negotiations between the UK and the EU on Brexit.

On the other hand, one comment confirmed the prospects of global economy remains positive as evidenced by the WEO by the IMF in October. Another comment pointed out that we should not be too pessimistic about the impacts of trade conflicts on our economy.

It is interesting to note that the discussion of prices as suggested by the summary was relatively limited. This may be because it is only a short period of time since the MPM conducted the review of formation of price and wage at its July meeting.

In fact, a couple of comments confirmed the view that the inflation rate is gradually accelerating on the back of continuously positive GDP gap. Other couple of comments presented the cautious views either by referring to the growing uncertainties about the global economy, or to the domestic factors including the improvement of productivities.

Discussion on monetary policy

As at the previous meetings of the MPM, members expressed the diversified views on the side-effects and the prospects of monetary stimulus.

First four comments confirmed the central view that the BOJ should maintain the current strong monetary stimulus in a persistent manner, in order to encourage the virtuous circle from income/profits to expenditure, resulting in achieving the inflation target.

Then the three comments discussed the Yield Curve Control (YCC). One comment appreciated the modification of management of the 10Y JGB yields, because we observed some flexibility of the yields and their movements were still contained.

Interestingly, other two comments raised the conflicting implications of the YCC. Among them, one comments cautioned that the market expectation about further flexibility of 10Y JGB yields could undermine the confidence in the BOJ's commitment in achieving the inflation target. The other comment expressed the concern that maintaining the target yield of 10Y JGB at 0% for lengthy period of time could rather prevent the improvement of inflation expectations. The comment further suggested further flexibility of the yields are desirable.

Next four comments discussed the side-effects on financial intermediation by banks from different perspectives.

Two comments reflected the conventional view of monetary policy. One of them argued that monetary policy could not increase the insufficient needs of borrowing in comparison to the size of financial industry. It emphasized that what monetary policy could do are to avoid deflation, and to expand nominal GDP.

Another of them shared the similar idea that, for addressing the problem of financial intermediation, we should not overlook the importance of prudential policy, rather than focusing on adjusting the target levels of policy rates.

Against this line of argument, a comment cautioned that, in assessing the risks of financials system, we should pay attention to the structural factors that could not described by economic models.

The other comment presented the more cautious view on financial institutions. It pointed out that some regional banks have increased loans to middle-risk firms in spite of the declining trend of lending rates. It raised concerns that their profits could deteriorate further, if our economy moves into a recession and the credit costs materialize.

Readers may like to note that this is one of the important message of the October issue of the Financial System Report (FSR) by the BOJ. For your reference, the JFSA separately estimated that about half of the regional banks effectively recorded negative profits from commercial banking business for the previous financial year.

Lastly, couple of comments affirmed the significance of strong monetary easing. One comment claimed that the BOJ should enhance the impacts on inflation expectations and seek further coordination of economic policy by the government. Another comment reiterated the view that the QQE has made substantial contributions to our economy.

Prospects of monetary policy

Readers may like to remember that, under the forward guidance introduced at July MPM, it is effectively hard to raise the policy target rates (both in terms of O/N and 10Y) at least until the impacts of consumption tax hike diminish. While, the BOJ could still modify the flexibility of 10Y yield, by looking at the domestic and overseas conditions, the BOJ could review the framework from medium-term perspectives.

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