Notes on Financial Markets Vol.88

Press conference by Governor Kuroda – Single mandate

11 March 2014

Introduction:

Except for minor downward revision of the short-term views on our exports, the BOJ maintained its economic and inflation outlook intact at today's monetary policy meeting. Moreover, large part of the discussion at the press conference today was the same as the previous occasion: backgrounds and implications of weaker than expected exports. If you like to recall, please visit our website for my previous Note in February.Let me give the outline of today's policy decision and review the highlight of press conference by Governor Kuroda.

http://fis.nri.co.jp/en/publication/Notes%20on%20Financial%20Markets.html

Nevertheless, I would like to raise several issues that could have implications for "additional stimulus" that has been strongly expected by the markets.

Inflation targeting

With regard to the QQE, we need to reaffirm that achieving the inflation target has outstanding importance. Almost an year ago, Mr. Kuroda was appointed by the cabinet with the mandate to save our economy from chronic deflation. This was why Governor Kuroda claimed that deflation is a monetary phenomenon that should be taken care of by the central bank, in spite of strong skepticism among economists.
This policy strategy of single mandate could have some apparent benefits. First of all, it could reinforce the commitment by the BOJ, which would result in the reversal of negative sentiment of broad-based economic agents. In my view, this mechanism actually functioned in Japan. Readers may also find it is similar to the "whatever it takes" statement by Governor Draghi in the autumn of 2012.
Moreover, this strategy could enhance the transparency of monetary policy. The markets could have more rational expectations over the course of monetary policy management in the future, by focusing their attention to the outlook of inflation by the central bank.
According to the comments either at the Diet or the recent press conferences, Governor Kuroda still firmly clings to this strategy. We could then argue that the crucial factor for "additional stimulus" would be any downward revision of its inflation outlook by the BOJ, which would make the achievement of the target less plausible.

Gap in priority

In reality, however, expectation for "additional stimulus" in the market tend to gain momentum whenever anything negative happens. This is one of the reason why the discussion at the recent press conferences have concentrated to the issues including weak demands for exports.
This line of argument is rational in a sense. It would be needless to say that weaker aggregate demand would relieve the upward pressures on prices, which would make the achievement of the target more difficult.
Nevertheless, I would like to raise several issues here. First, some part of the market may still suspect that the BOJ would manage monetary policy at discretion based on the broader set of economic factors. We could not blame them, because this line of thought is standard in normal times (or you like to refer to the policy strategy by the FRB in coming months). Under our environment, however, the BOJ may need to enhance communication to share appropriate understandings.
Second, the relationships between the inflation and the aggregate demand-supply may have become unstable or uncertain.
For example, as Governor Kuroda reiterated at today's conference, we observe a remarkable set of developments in our labor market. In fact, our unemployment rate has fallen to a level close to "full employment", and a number of large corporations are going accept the raise in ordinary wages, first time in long years.
It should be noted that these factors, which would doubtlessly have non-negligible impacts on our inflation, have been developing under lackluster macro-economic performances. You would remember that annual rate of growth in 4Q 2012 was further revised down to 0.7%, marginally larger than our estimated rate of potential growth.
Third, there is rather strong view in the market that the BOJ may put high priority to make surprise when they decide whatever actions for monetary policy. As readers remember, this kind of belief was reinforced further by the set of policy decisions at the MPM in February.
Apparently, the BOJ could not make surprise at every policy decision forever. But at the same time, the BOJ would not be able to disregard this element altogether. As is common to unconventional monetary policy, transmission of effects of the QQE always starts in the markets.
Fourth, some part of the markets also suspect that the BOJ would finally decide "additional stimulus", if and when any political factors would work. From their point of view, the cases would include1) the failure to make meaningful steps forward the "third arrow" in the end, or 2) the need to boost our economy to prepare for the negative impacts by consumption tax hike of second round.
In light of the circumstances of Governor Kuroda's regime, the markets may have good reasons for paying intense attention to such political factors for monetary policy conducts. Moreover, making policy decision based on some set of political factors (including 2) above) would rather be consistent with policy decisions based on economic factors.
All in all, however, these issues seem to cause some gaps in priorities in policy decision by the central bank and its perception by the markets.

Conclusions

If and when something that have significant impacts happens, the BOJ's decision would be straightforward. Otherwise, we could observe more complicated debates over the course of monetary policy, in spite of the original idea of the QQE.

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