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Press conference by Governor Kuroda— YCC revisited

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Introduction

In contrast to the FOMC meeting in earlier hours in Tokyo time today, the MPM meeting this time attracted little attention in the market. Nevertheless, we noticed some signs of evolution on the discussion of the yield curve control (YCC).

Economic assessments

MPM members mostly maintained their views of domestic economic activities, which were evaluated at the time of quarterly review of economic/inflation outlook in January this year. In fact, Governor Kuroda implied that our economy has been on the right track of gradual recovery.

It is also the case with inflation. Disappearance of downward pressure by crude oil price has pushed up the indicator of headline rate of inflation. It should be noted, however, underlying rate of inflation as measured by a range of indicators has still been crawling around 0%. In light of diminishing gap of aggregate supply/demand, we need to seek alternative set of culprit. Those of course include extremely low rate of inflation expectations and their adaptive way of formation.

All in all, Governor Kuroda confirmed that the BOJ commits itself in maintaining strong monetary stimulus, because achieving the inflation target would still be somewhat distant.

Yield curve control

Interestingly, growing number of market participants wonder whether the BOJ would raise the target yield in YCC sometime later this year. This is the reason why a number of reporters raised this issue again at the press conference today.

With regard to its backgrounds, a few press reporters asked whether the upward pressures on JGB yield transmitted from overseas economies and financial markets could trigger an upward adjustments of the target yield of 10Y JGB.

In reply, Governor Kuroda denied such possibility, and confirmed that any adjustments of the target yield should be based on the assessment of inflation outlook. In other words, the BOJ would not raise the target yield, unless they notice substantial improvement of inflation outlook.

More fundamentally, some of the reporters suggested that it would be desirable for the BOJ to share some concrete conditions to adjust the target yield of 10Y JGB. In reply, Governor Kuroda explained that it would not be practical to set and share some numerical conditions.

According to his accounts, the BOJ would need to observe the improvements of underlying inflation, some of these indicators may not be directly observed. In fact, Governor Kuroda reiterated the view that aggregate gap of demand/supply as well as long-term expectation of inflation would be the keys.

While these lines of thoughts would be reasonable, repeated discussion on appropriate conduct of the yield curve control (YCC) reveals several fundamental challenges of the current policy framework.

First, the relationship between “equilibrium yield curve” and policy target yield. In theory, the BOJ may adjust the target yield consistent with the equilibrium taking account of the current economic fundamentals. Nevertheless, the BOJ sometimes seemed to claim that pegging the long-term yield as low as possible could maximize the magnitude of monetary stimulus. This is a similar line of thoughts as a gap between short-term policy rate and natural rate of interest would imply the magnitude of monetary easing under conventional monetary policy.

Second, consistency between the interest rate and the quantity of fund injection. As suggested by the BOJ, net purchase of JGB by ¥80trn would be consistent with the current target yield of 10Y JGB (at 0%). It would rather be easy to understand, however, that actual amounts of JGB purchase by the BOJ could vary depending on the conditions of the markets.

For example, if there is upward pressures on JGB yields due to considerable re-pricing of US government notes, the BOJ might need to purchase larger amount of JGB in order to defend the target yield. While the domestic market participants have gradually learn that the BOJ would prioritize in preserving the target yield by utilizing some flexibility of quantitative target of fund injection, the markets would not know the boundary of such flexibility.

Third, the linkage between the O/N policy rate and the target yield of 10YJGB. In fact, a press reporter raised this issue today. Governor Kuroda insisted that the BOJ would manage the NIRP taking into account of economic, inflation and financial conditions. Moreover, he added that evaluations of financial condition would include the side-effects of NIRP on a range of financial institutions.

Governor Kuroda’s comment could suggest that the BOJ could adjust the NIRP regardless of its adjustment in the target yield. If it could be the case, the markets would then wonder the significance of “equilibrium yield curve” as the backgrounds of the optimal position of YCC.

G20 meeting in Germany

Just ahead of G20 Financial Ministers and Governors of Central Banks meeting, a few press reporters asked about its prospective points of its discussion. Governor Kuroda of course declined any official comments. He still confirmed that the Japanese Government is in opposition against competitive devaluation and trade protectionism, both of which would prevent a sound expansion of international trade, a key source of global economic growth.

Reporters have good reasons for raising these issues, since there have been some international press reports that there could be some substantial modifications of the communique of the meeting above. These could have non-negligible impacts of financial markets, rather than the modest change in interest rate differential in long-term yields after the monetary policy event across the Pacific.

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