Press conference by Governor Kuroda : Inflation gap

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Introduction

The MPM of the BOJ made upward revision of the outlook of real GDP growth at their quarterly review. While it had been expected by the domestic markets, the revised outlook appears to be modestly bullish in light of our potential growth rate. It was interesting to note, however, the MPM made little revision of their persistently cautious outlook of inflation.

Upward revision of economic outlook

The outlook of real GDP growth implies the bullish assessment of economic activities. According to its summary text, the MPM has become confident in the gradual recovery of private consumption thanks to secure improvement of employment and earnings. Moreover, the MPM made sure of the recovery of our exports, which (coupled with the adjustment of inventory) resulted in restarting the expansion of industrial production.

Readers may remember that the MPM had noticed some signs of temporary slowdown at their previous round of review in October. Most of them have disappeared, according to the consensus views of the MPM. Moreover, the summary text suggests that the improvements of financial conditions have also contributed to better sentiment of corporate managers.

All in all, their expected rates of real GDP growth from FY2016 to FY2018 became +1.4%→+1.5%→+1.1%. In comparison with their previous outlook, the rates increased by +0.4pp for FY2016 and +0.2pp for FY2017 and FY2018 respectively. The MPM explained that some of the revision was a result of regular revision of our SNA. Nevertheless, we could understand that the MPM effectively made the series of real GDP growth rate by some 0.2pp throughout the period.

Cautious outlook of inflation and its implications

In contrast, the MPM maintained their outlook of inflation mostly unchanged. In fact, only adjustment in these fiscal years was made for FY2016 (-0.1%→-0.2%). It would seem somewhat inconsistent, in light of the bullish outlook of our economic growth. In fact, the summary text suggests the consensus view of the MPM that the GDP gap would disappear in the near future, since we could enjoy our economic growth in coming years at a much faster pace than our potential growth.

In fact, some press reporters asked Governor Kuroda about the reasons for such discrepancy of the outlook. His answer was not so straightforward.

Nevertheless, he implied that the MPM members may have been disappointed at slow improvements of actual rate of inflation in spite of diminishing effect of crude oil prices. Since our inflation expectation remains “adaptive” for a large part, recent lackluster performance would prevent meaningful improvement of inflation expectation, which has led to the MPM’s bearish outlook of inflation at least for the moment.

We could think of the alternative background for such discrepancy. If the MPM had also made substantial upward revision of inflation outlook, the markets may have become aware of potential upward revision of policy target at 10YJGB. The MPM would apparently liked to avoid such reactions from the markets, because it could further delay the timing of achieving the inflation target. Moreover, as we discussed in the previous issue of my Notes, there are a number of issues in relation to appropriate and smooth adjustment of 10Y target rate, including the identification of its optimal level.

If this would be the case at least to some extent, one important implication would be considerably “low elasticity” of policy target at 10YJGB rate to the improvements of economic performances as well as its MPM’s outlook.

Risks to the outlook

Another interesting part of the MPM’s outlook was the assessment of the balance of risks. In fact, the MPM maintained their view that the balance is still tilted downward both for real GDP growth as well as inflation.

In terms of inflation, factors that the MPM raised were straightforward. They are uncertainties about long-term inflation expectations, existence of goods and services inelastic to demand/supply conditions, and developments of exchange rates and international commodity prices.

With regard to the real GDP growth, the MPM members kept their eyes on a number of risk factors that could be realized in overseas economies, including developments of US economy and their monetary policy, financial stability issues in some European states as well as recovery of large emerging economies.

Not surprisingly, a number of press reporters asked Governor Kuroda about the implications and impacts of economic policy by President Trump. Governor Kuroda confirmed the view that expansionary fiscal policy would further improve the economic performance of the US, which have already been expanding moderately. Therefore, Governor Kuroda expected the positive spillover effect across the global economy, resulting in some benefits to us.

Some of the press reporters were not convinced by such optimistic scenario, however. They expressed concerns about the possibility of President Trump’s touch stance toward international trade policy. Moreover, they referred to the risk of political pressure on exchange rate policy, if and when the US administration would not be satisfied with their performance of trade against Japan.

Governor Kuroda implied the inappropriateness of excess focus on bilateral trade balance and referred to the consensus of exchange rate policy in the international financial community.

Readers may become aware that it would be uncommon for a central banker in Japan to make such comments on some political issues. Possibly, it was due to the fact that Mr. Kuroda was once the head of exchange rate policy as a government official. Alternatively, it may have reflected his mind that he would like to protect the improvements of our economy and prices as the hard-won achievement of the QQE from any kinds of external shocks.

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