Notes on Financial Markets Vol.165

Press conference by Governor Kuroda —Clarification

April 25, 2019

Introduction

Unexpectedly, Monetary Policy Meeting (MPM) today decided a number of policy actions, including the modification of their forward guidance. In spite of muted reaction of the domestic markets, the policy decision have some interesting implications from strategic perspectives.

Outlook of economy and inflation

Before discussing the policy actions in detail, I would like to review their outlook revised at the MPM today.

They largely maintained the outlook of real GDP rates. Median rates of the outlook by the board members from FY2019 to FY2021 is +0.8%→+0.9%→+1.2%. For your reference, it was+0.9%→+1.0% from FY 2019 to FY2020 in January. While it may appear low to overseas readers, all of them are higher than the estimated potential growth rate.

In fact, its summary text emphasizes that the MPM maintained their main scenario of gradual but continuous expansion of our economy. It depends largely on the expectation of recovery of overseas economies, thanks to stimulus measures and inventory adjustment of IT-related goods.

As a result of such constructive views, the MPM also maintained the outlook of core CPI inflation rates (excluding the impacts of consumption tax hike and free education). Median rates of the outlook by the board members from FY2019 to FY2021 is +0.9%→+1.3%→+1.6%. In comparison, their previous outlook as of was +0.9%→+1.4% from FY 2019 to FY2020.

Looking ahead, the MPM kept aware of larger downside risks. While they maintained the list of factors, the summary text highlighted the elevated uncertainties of overseas economies, which could have substantial impacts on the minds of firms and households.

Modification of forward guidance

In spite of the maintenance of outlook, the MPM decided to modify the forward guidance. In comparison to the previous one, the MPM added the factor of overseas economies and introduced the calendar-based forward guidance.

The BOJ now expects that they will maintain the extremely low target levels of short and long interest rates at least through around spring 2020. This is due to taking account of uncertainties regarding the overseas economies and the effects of consumption tax hike.

A number of reporters asked Governor Kuroda about the reason of modification. He emphasized that it is intended to clarify the existing forward guidance as the title of the policy statement suggests. He further explained that the MPM would like to prevent the market speculation about policy rate hike after the consumption tax hike (scheduled in October 2019).

From the viewpoint of economic fundamentals, the modified forward guidance would be consistent with the central scenario of our economy as their economic outlook suggests. This is why the MPM included the factor of overseas economies that should be taken account of.

It should be noted, however, recent surveys of market participants and economists implied that there seemed to be few experts who expected the BOJ to start raising policy rates earlier than spring 2020. Only probable risk could be market speculation about an one-off modification of policy rates to enhance sustainability of the YCC.

All in all, the new forward guidance by the BOJ appears to be similar to that by the ECB. Both cases seem to confirm the existing expectation in the market. They could contribute to avoid unnecessary market volatility, but the central banks would need to update the forward guidance according to the fluctuation of market expectations ahead.

Expansion of eligible collateral

Although no reporters raised this issue at the press conference, the author is considerably interested in this technical but important measure.

The MPM decided to accept the debts of private companies with BBB ratings. Moreover, among those without such ratings, the BOJ will accept the debt of private companies classified as “normal” by self-assessment by financial institutions. For the case of loans to municipal governments, the BOJ will not require the auctions for determining the lending conditions.

Moreover, the BOJ will increase the eligible amount of the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth for each financial institution, based on the amount of its utilization in the past.

The couple of policy decisions above is apparently intended to enhance the attractiveness of existing measure for stimulating bank lending. Furthermore, the focus is the regional banks, in light of the features of private companies whose debt will become eligible for the BOJ’s fund provision.

All in all, the expansion of eligible collateral appears to be the policy response by the BOJ to the growing concerns about the side-effects of extremely low yield environment on financial intermediation in our domestic economy.

While there remains uncertainties about its effects in light of modest strength of the loan demands by SMEs, it would makes sense to facilitate funds to the companies classified as “normal” by financial institutions. My discussion with senior persons of regional banks suggest that firms of this category have both problem and potential.

Asset purchase

Last set of the policy decision included the enhancement of lending program of JGB and the introduction of ETF lending. Regarding the latter initiative, Governor Kuroda implied that it would be necessary to support the market making practice. Looking from different perspective, the decision would be another evidence of the pressures on the market functions.

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