Notes on Financial Markets Vol.161

Press conference by Governor Kuroda — GDP gap targeting

January 23, 2019

Introduction

Monetary Policy Meeting (MPM) of the BOJ today decided to keep the accommodative monetary policy unchanged as expected. Point of focus in the market was rather the revision of the outlook, and the discussion by Governor Kuroda included something worth noting.

Revised outlook of economy

The MPM largely maintained their constructive outlook of economic activities both in FY2019, and FY2020, while they made substantial downward revision for FY2018. Their new outlook of real GDP growth rates from FY2018 to FY2020 is+0.9%→+0.9%→+1.0%. For your reference, the previous one was +1.4%→+0.8%→+0.8% (in October).

Large downward revision for the current FY is apparently due to the underperformance of our economy in the 2Q (from June to September), because of a series of natural disasters.

In the meantime, slight upward revision for FY2019 and FY2020 is probably due to new estimation of the effects of policy measures by the government to minimize the short-term impact of consumption tax hike. Readers may like to note that the IMF also made slight upward revision of expected growth rate for CY2019 for the same reason.

With regard to prices, the MPM made a large downward revision of its outlook for FY2019. Their new outlook of core CPI inflation rates from FY2018 to FY2020 is+0.8%→+1.1%→+1.5%. For your reference, the previous one was +0.9%→+1.6%→+1.6% (in October).

We should take account of the effects of policy measure again. While the MPM already took into consideration of the impacts of consumption tax hike (scheduled in October 2019), it has become able to estimate the impacts of making pre-school and high-school education free of charge, thanks to the clarification of the scheme.

The MPM released their outlook of core CPI inflation excluding these impacts: +0.8% → +0.9% → +1.4%, in comparison with the previous one in October (+0.9% → +1.4% → +1.5%). They also implied that the estimated direct impacts of the change in education policy for FY2019 and FY2020 is 0.3pp and 0.4pp respectively (as shown in the footnote of the main text of outlook).

All in all, downward revision of their inflation outlook due to the reasons other than the policy issues is substantial only for FY2019. Governor Kuroda reiterated the accounts in the main text and explained that it is largely because of the drop in crude oil prices.

Assessment of risks

Large part of the MPM's discussion of risks of economic activities remained unchanged. Nevertheless, they referred to the potential spillover impacts of trade disputes between the US and China. Moreover, they confirmed that the downside risks of overseas economy (not only limited to the trade disputes) is reinforcing.

Observers of the press conference by Governor Kuroda, however, may have felt a slightly hawkish tone of voice. He insisted several times that the main scenario of global economy remained unchanged, while he confirmed that the potential sources of risks and their impacts have evolved since the previous year. Interestingly, he referred to the deceleration of economic growth in Europe and some emerging economies, but confirmed the continuous expansion of economic activities in the US and China.

In particular, regarding China, he expressed the positive view on the outcome of ongoing negotiations against the US, and expected the intended effects of economic policy measures by Chinese government. While he noticed the cautious views by Japanese firms on the export demand from China, he implied that it would not have direct impacts on industrial production for the time being in light of the elevated level of outstanding orders.

It should also be noted that the MPM had already made downward revision of risks for our economy at the previous round of outlook (in October). In light of this fact, Governor Kuroda may like to claim that there emerge few additional factors to alter their already cautious assessment of risks.

The discussion of risks of inflation seems to be further complicated. As discussed earlier, the MPM now expected the substantial deceleration of core CPI inflation rate in FY2019, but due to the carried-over effects of drop in crude oil prices and the impacts of policy measures.

Their outlook of remarkable acceleration of core CPI inflation rate in FY2020 suggests that the impacts of factors above would only be temporary, and the underlying trend of gradual acceleration of inflation could be maintained. In fact, their points of discussion of risks of inflation, as shown in the main text of the new outlook, remained unchanged from the previous one in October.

From the view point of financial markets, any increase in uncertainties about the global economy could undermine the sentiment. It could lead to appreciation of JPY, resulting in downward pressures on domestic prices. Nevertheless, recent prompt reversal of JPY rates from their recent peak around the turn of the year could enhance the confidence in stability of JPY rate for the time being.

Policy target

Since Governor Kuroda had successfully decoupled the direct link between the outlook of inflation and the additional monetary stimulus (at least within the certain range of inflation rate), the markets did not expect the policy action by the BOJ even if they made downward revision of outlook.

Governor Kuroda emphasized at the press conference today that it is utmost important for the BOJ to maintain the positive GDP gap in order to maintain the underlying trend of inflation. Conventional central bankers would agree that this is what a central bank could do on this policy front.

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