

Introduction

The MPM of BOJ virtually maintained their economic outlook, and decided to keep the QQE unchanged. Nevertheless, their report on economic outlook includes some interesting elements that could have medium-term implications.

Review of the outlook

After the semi-annual review, the new outlook of real GDP growth rates is +2.0% for FY2015 and +1.5% for FY 2016. Readers may like to recall that their previous outlook at January is +2.1% for FY2015 and +1.6% for FY 2016. In terms of CPI inflation rate, the MPM made downward revision, but only marginally (For FY 2015: +1.0%→+0.8%, FY2016: +2.2%→+2.0%).

Governor Kuroda reiterated the view that mechanism of economic expansion would remain intact for both years. Private consumption would grow thanks to increase in earnings as well as drop in energy prices. Business investments would sustain due to continuous improvements of corporate profits.

At the same time, Governor Kuroda maintained the expected path of CPI inflation unchanged. With diminishing effects of crude oil price as early as the second half of FY2015, CPI inflation would accelerate again largely due to positive aggregate demand and supply gap and improving inflation expectation in an adaptive manner.

First half of FY2016

The MPM now expects that their inflation target (2% as CPI inflation) could be achieved in the first half of FY2016 (from April to September), according to the text of their outlook.

As Governor Kuroda admitted at the press conference, this implies the marginal delay of its timing. Until today's MPM, the BOJ maintained the view that the inflation target would be achieved sometime during the term centered in FY2015. According to Governor Kuroda's previous account, this term refers to FY2015 and earlier period of FY 2016.

In any case, new announcement is the clearest reference to the specific term. The BOJ may have accepted the renewed transparency of achieving the target, in exchange for the marginal delay in achieving the target.

Some press reporters continued to criticize the MPM because the new target term would not be consistent to the original commitment of 2% inflation in two years. In reply to the criticism, Governor Kuroda insisted that their commitment is still important for improving inflation expectation.

Moreover, Governor Kuroda explained that improvements of underlying inflation as measured by aggregate demand and supply gap and/or inflation expectation remain intact largely because of the BOJ's commitment in achieving the target.

It is important to note that we now have clearer conditions for another round of stimulus. If and when the probability of achieving the target in the first half of FY2016 is substantially lowered, the BOJ is ready to enhance the current QQE.

According to the text of economic outlook, a possible source of undershooting the target would be deteriorating inflation expectations due to lackluster trajectory of actual inflation. It appears to be the case with October 2014, when the BOJ enhanced the QQE.

Normalization of the monetary policy

Some reporters asked Governor Kuroda if the BOJ seriously considers the normalization of the QQE in FY2017, after having achieved 2% CPI inflation in two consecutive years (as the new outlook suggests).

Governor Kuroda explained that the policy decision would not be so mechanical, and expressed his view that the MPM would take into account of inflation expectation by broad range of economic agents as well as economic outlook at the time.

We could ask, however, about the monetary policy in FY2017, from different viewpoints. This is because the MPM's outlook of economic growth for FY 2017 is extremely low (+0.2%) in light of their relatively bullish outlook of CPI inflation for FY2017 (+1.9%).

It should be noted that the MPM have already taken into account of a possible negative impacts of the next round of consumption tax hike. A footnote of the new outlook implies the MPM estimates 0.8%pp as the impacts on real GDP growth rate. Nevertheless, further deceleration of economic growth for FY2017 would be caused by maturing cycle of business investments, as Governor Kuroda explained.

While we would not expect a sharp decline of economic activities in FY2017 solely because of a second round of consumption tax hike, we could observe some deceleration of economic growth as the new outlook suggests. Therefore, important policy agenda for FY2017 would be to revitalize the economic momentum rather than the normalization of monetary policy.

Another important implication would be that further delay in achieving the inflation target would be seriously problematic for the BOJ. FY2017 would not be an optimal year to achieved the target. As the MPM suggests, our economy in FY2017 would be negatively affected by a consumption tax hike and slowdown in business investments.

Implication of US economy

Interestingly, several reporters raised the issue of the US economy. Some of them asked Governor Kuroda about the impacts of possible slowdown of the US economy. They seemed to become cautious about the US economy, after having observed the GDP growth rate for the first quarter.

Others raised the issue of foreign exchange rate. They expressed concerns that an additional stimulus by the BOJ could become difficult, if and when the US economy could not tolerate the cost of rising US dollar. They seemed to become cautious about the views of the FRB, after having read the policy statement of the FOMC.

Although Governor Kuroda denied both scenario for now, they could become relevant, if domestic economy loses growth momentum.

Author: Tetsuya Inoue
General Manager and Chief Researcher
Financial Technology and Market Research Department
Nomura Research Institute

This note is intended solely for informational purposes and should not be construed as investment advice. The author does not guarantee the accuracy or completeness of the information contained. Opinions in this note are those of the author and do not represent the views of Nomura Research Institute or Financial Technology and Market Research Department. This note is exclusively for the personal use of those receiving it directly from the author.