Notes on Financial Markets Vol.114

Press conference by Governor Kuroda — Invisible elements

October 30, 2015

Introduction

We observed diversified views in the markets until today on anther round of additional stimulus, and both sides of the views had good rationales respectively. This may be the reason why the market reactions so far are modest. Nonetheless, the BOJ's policy decision to maintain the current scale and composition of QQE raised some interesting issues.

Economic outlook

As widely expected, the MPM revised down its economic outlook for FY2015 (12 months period ending in March 2016). Their outlook of real GDP growth rate and core CPI inflation rate have changed to +1.2% and +0.1%. These numbers as of July were +1.7% and +0.7% respectively. For FY2016, while their outlook for real GDP growth rate has virtually remained the same (+1.5→+1.4%), that for core CPI inflation rate has dropped again (+1.9%→+1.4%).

Substantial downward revision of the inflation outlook has led the BOJ to postpone the prospective time of achieving the inflation target from "first half of FY2015" to "second half of FY2016 (from October 2016 to March 2017)". As a result, the BOJ is effectively trying to achieve their goal with four years of QQE, which is now twice as long as their original commitment.

Behind the downgraded outlook, however, the MPM has sent constructive lines of views. First, the MPM confirmed its bullish assessment of our domestic economy. According to their accounts, household spending is returning to growth path supported by improving labor conditions, and business investments is showing encouraging signs as implied by TANKAN survey.

Second, the MPM sees the resiliency of emerging economies as central scenario. At the same time, they expect that gradual but secure economic expansion in advanced economies could have good spillover effects over emerging economies, which in the end would result in stabilization of global economy.

All in all, the MPM understands that most of the factors to make downward revision of their outlook are behind us, as Governor Kuroda explained at press conference today. These include faster than expected slowdown of our exports and longer than expected drop of commodity prices.

Nevertheless, Governor Kuroda admitted that overall risks of growth and inflation were tilted downward. Readers could confirm such feature by looking at the new chart attached at the end of the outlook. Especially on the outlook of CPI inflation rate, not a small number of gray triangles implies that several MPM members see the downside risk. Summary of outlook suggests their views may be backed by some concerns on economic fundamentals rather than simple probability of further delayed recovery of commodity prices.

Commitment in inflation targeting

At the press conference, reporters raised some sets of fundamental issues of QQE, rather than asking the plausibility of the MPM's outlook as reviewed above.

First, some of them asked if consecutive postponement of prospective timing to achieve the inflation target would hurt the credibility of QQE. Governor Kuroda explained that the MPM judged the magnitude of monetary easing to be appropriate for now. As the major reasons, he refereed to two factors: improving "underlying inflation" and gradual expansion scenario of our economy.

Nevertheless, there remains some factors that may deserve discussion. Among the components of "underlying inflation", there are emerging signs of downward movements even among the survey-based estimates of inflation expectation, as Governor Kuroda admitted. More importantly, while "underlying inflation" is a clear concept, it is a delicate tool for communication policy, because it is invisible for outside observers.

Second, some press reporters expressed skeptical views on the BOJ's ability to achieve 2% inflation even in the long run. Governor Kuroda reiterated the view that we have observed substantial improvements of long-term inflation expectation by economic agents thanks to QQE. While he accepted that improvement of actual inflation has been slower than expected, he understood most of the downward pressures were temporary and expected our actual inflation could gradually become higher in coming quarters.

We could find some factors for counter-argument. Summary of outlook refers to the risk of non-linearity of relationship between the tightness of demand and the actual prices in some markets. Interestingly, at least some members of the MPM would be frustrated with extremely slow recovery of nominal wages under "full employment" conditions. Moreover, summary of outlook refers to the possibility of small demand elasticity of prices of some public services and housing rents.

In spite of these suspects and concerns, it should be noted that Governor Kuroda said that the commitment in inflation target remained unchanged. Moreover, he denied the possible technical limitations over increasing the scale of JGB purchase, by referring to much larger share of BOE's Gilts holdings among its outstanding amounts.

Communication policy

Governor Kuroda's rhetoric today seems to be closer to that of statement of recent FOMC meeting. Both of them show confidence in resiliency of their own domestic economy that could withstand the potential downward pressures from overseas. In light of growing sense of downside risks expressed by several MPM members, however, Governor Kuroda could conduct a different line of communication, which is closer to that of ECB. President Draghi highlighted the downside risks from emerging economies (rather than their central scenario of "muddle through") and thereby easing financial conditions.

If the reason to refrain from such "verbal intervention" By Governor Kuroda is the real confidence in resiliency of our economy and prices, this is a consistent and self-contained story. If otherwise the reason is the consideration on possible impacts on foreign exchange rates as invisible factors for policy decision, communication policy by the BOJ could become complicated at least.

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