

## Introduction

While all the markets concentrate their attention to a policy decision by the ECB tomorrow, policy discussion by the BOJ this time was modestly interesting, especially from longer-term perspectives.

Let me discuss several points of Governor Kuroda's press conference today.

## Economic outlook

At their mid-term review today, the MPM made substantial revisions of their semi-annual outlook. For FY2015, they lowered their outlook of core inflation (+1.7%→+1.0%), but raised the outlook of GDP growth rate (+1.5%→+2.1%).

Not surprisingly, Governor Kuroda explained that the downward revision of inflation outlook is due to fall in crude oil prices. It is rather interesting to me that their new outlook seems to be unchanged if the effects of crude oil price fall are excluded. In fact, the magnitude is estimated to be 0.7%pp according to the footnote of the BOJ's outlook.

Regarding the upward revision of growth outlook, Governor Kuroda pointed out that both economic stimulus measures by the government and fall in crude oil price are expected to have positive effects. The first factor implicitly includes the removal of possible negative impacts by a second round of consumption tax hike (postponed to April 2017).

For FY2016, the MPM made further upward revision of their growth outlook (+1.2%→+1.6%), but maintained their inflation outlook virtually unchanged (+2.1%→+2.2%). While Governor Kuroda did not refer to this fact, their growth outlook appears to be reasonable, if you could have confidence in their growth outlook for FY2015, and the effects of short-term factors would be diminishing. Moreover, their inflation outlook appears to be consistent, once you have confidence in their growth outlook.

## Policy decision – effects of crude oil

As expected, a number of press reporters asked Governor Kuroda the reason why the QQE was left unchanged when the MPM lowered their inflation outlook substantially.

In reaction, Governor Kuroda explained the two major points. First, the majority of the MPM expects that the inflation rate could return to a previous path, once the level effects of crude oil price disappears. Moreover, rapid growth of aggregate demands (due to the factors mentioned above) could accelerate the inflation rate. This is why the MPM still expects a high rate of inflation for FY2016.

Apparently, there is a caveat here. Their expected path of inflation would be affected considerably by a future course of crude oil price. In fact, the outlook is based on the specific assumption of crude oil prices until the end of FY2016 – gradual recovery from \$55/br to \$70/br in two years.

With regard to this risk factor, Governor Kuroda implicitly expressed his idea by referring to the fact that survey-based inflation expectation has seemed to be stabilized since the crude oil fall began in last autumn. Moreover, he insisted that further improvements of aggregate demand and supply balance due to relatively high growth rate for FY2015 (+2.1%) would further stimulate our inflation expectation.

While Governor Kuroda's these accounts sound reasonable, readers may still wonder the reason why the BOJ conducted the additional stimulus in October last year. In fact, at that

time, Governor Kuroda insisted that it was important to reduce the risk of re-emerging deflation expectations if crude oil price would drop further (and it actually did).

In response to a few questions by press reporters, Governor Kuroda explained that momentum of economic growth was considerably weak in October (but it would not be the case with today).

## Policy decision – reaching 2% inflation

Second major point that Governor Kuroda explained was the timing of reaching 2% inflation. He explicitly admitted that it could be later by several months than the end of FY 2015. This is the point that both domestic and overseas press have already highlighted, and reported that the BOJ effectively postponed their target date of policy commitment.

It should be noted, however, the BOJ has maintained their statement that inflation rate would reach 2% around the middle of the projection period, that is in or around FY 2015. According to Governor Kuroda's comment today, reaching 2% inflation in an early month of FY2016 could still be consistent with the statements above.

Moreover, it would be important to note the expected trajectory of inflation for FY2015. Because we could doubtlessly observe further downward pressures on inflation in coming months but the MPM's outlook of inflation is +1.0% on average for FY2015, the MPM implicitly expects rapid recovery of inflation rate as the level effects diminishes. And this is why the MPM further expects +2.2% inflation for FY 2016.

All in all, Governor Kuroda would like to insist that 2% inflation could still be reached in a consistent manner with their existing commitment, even if with a "negligible" overdue. These are his (and the majority of the MPM's ) basic lines of thought on today's decision to maintain the QQE unchanged.

## Conclusion

Based on the discussion above, I would not think that the BOJ has made substantial revision of the policy idea or commitment of the QQE. Still, there are couple of points that deserves attention by those who look at the BOJ's policy from longer-term perspectives.

Firstly, Governor Kuroda explicitly refers to the strength of economic activity as the backgrounds for the additional stimulus. And secondly, Governor Kuroda explicitly expresses readiness to accept some allowances in reaching 2% inflation.

I would agree that abandoning the fundamental idea of the QQE, especially when we are still on the way to the achievement of inflation target, could damage the policy effects altogether. I would also suspect that securing some flexibility of the QQE by Governor Kuroda's deliberate address could be beneficial for the BOJ in such complex economic and financial conditions.

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