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Press conference by Governor Kuroda – Conditional commitment

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Introduction

With prices of broad-based commodities have been losing ground, their implications for BOJ's monetary policy are attracting attention, especially in light of the additional stimulus in last October. In reaction, Governor Kuroda's press conference today appeared to send a slightly different tone of message to the markets.

Assessment of economy

The MPM maintained its bullish view on our economy, especially on domestic front. They expect continuous recovery of private consumption with the backgrounds of modest increase in earnings and further tightening of employment. As discussed earlier, business investment is on gradual expansion path as improvement of business sentiment.

Moreover, Governor Kuroda explained today that probably weak number of GDP growth in 2Q was largely due to transitory factors including bad weather in June and lagged effects of weak economic performance in the US in 1Q. All in all, he effectively implied that the worst is behind us.

While the MPM expressed somewhat cautious view on external demands (like other central banks), Governor Kuroda explained that recovery in advanced economies will contribute to gradual recovery of emerging economies, resulting in moderate expansion of global economy as a whole.

In contrast, representing the concerns in our markets, some press reporters expressed suspects that the MPM's view would be too bullish by way of referring to the idea that recent further drop in commodity prices may reflect substantially weaker demand from emerging economies.

In a sense, Governor Kuroda did not make clear his reaction to this kind of concern, but mentioned that not only factors on demand side but also those on supply side have contributed to downward movement of commodity prices. This is the point where some of the reporters were not persuaded to accept. Moreover, this is the element that links the assessment of our economy with the management of QQE.

Inflation target and QQE

If the downward pressures on commodity prices would remain, acceleration in inflation rate would be further postponed. With this respect, Governor Kuroda clearly admitted today that the timing of achievement of inflation target could be somewhat earlier or later than the first half of FY2016, depending on the developments of commodity prices in coming months.

In relation to the target, introduction of new "core-core" measure of CPI inflation (excluding flesh food and energy) by the BOJ at the time of monthly review in last month has attracted attention in our markets. In fact, some reporters raised this issue today and asked whether the BOJ would switch the target indicator under the QQE.

Governor Kuroda admitted that the BOJ introduced this new indicator in order to improve their understandings of "underlying" inflation which have been masked by increasing volatilities of commodity prices. Nevertheless, Mr. Kuroda insisted that this would be only one of many relevant indicators and the BOJ would monitor broad range of them including inflation expectation and nominal wage. Moreover, Governor Kuroda emphasized that the BOJ continues to pursue the target in terms of headline CPI inflation.

In terms of the management of QQE, it is important to note that Governor Kuroda reiterated his idea that any "adjustment" of monetary policy would depend on the impacts of economic shocks on "underlying" inflation.

Taking into account of his flexible view of the timing of achievement of the target (as discussed above), he seems to claim effectively that prospect of failure to achieve the target sometime in the first half of FY2016 would not automatically require another round of monetary stimulus. He would rather imply that the BOJ would be ready to conduct another action if there would be downside risk of "underlying" inflation.

We could draw some implications from this line of discussion. First, the BOJ may be going to secure some flexibility of timing of achieving the target as far as dynamics of commodity prices would be dominant factors. Second, it would be more difficult for outside observers to see if the conditions of monetary policy action would be satisfied or not. Because the indicators of "underlying" inflation would be broad-based as Governor Kuroda implies.

Prospective reactions of the markets to these implications could be muted, especially on our domestic front. Readers may be aware that there is already a growing skepticism in our market about another round of additional stimulus by the BOJ, both from the viewpoints of its effects and its potential side-effects.

We would still wonder whether this implicit modification of policy strategy would have impacts on the existing effects of QQE especially on inflation expectation by economic agents. Because the absolute goal of QQE is to remove our tendency of returning to deflation expectations, pro-active management of QQE may still have some significance. It would be all the more true when we would not have a hysteresis of inflation rates meaningfully distant from zero.

Concluding remarks

Unless we could have surprising recovery of commodity prices as well as domestic prices, the MPM would need to revise down its inflation outlook at least for FY2015 at the time of next semi-annual revision. Similarly, as discussed above, the MPM would also need to revise down its growth outlook at least for FY2015.

While we could still claim these are largely due to the factors in the past, there could be a growing discussion about another round of additional stimulus. Under such conditions, communication policy by the BOJ could face some challenges in gaining understanding of the strategy of conditional commitment.

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