

## Introduction

The BOJ maintained the QQE as expected at today's MPM. Moreover, the MPM members made slight upward revisions both in terms of short-term economic outlook and inflation expectation. Nevertheless, the discussion at the press conference was rather active for obvious reasons. Let me review the focused issues.

## Fiscal Consolidation

Very large number of press reporters raised this important issue from some different perspectives. First of all, some of them asked whether the rises of the consumption tax rate as scheduled would pose threat to achieving the inflation target.

Governor Kuroda's answer was straightforward. He reiterated the fact that the MPM members already took into account of its temporary negative impacts when they estimated their economic outlook in July. According to their views, as Governor insisted, GDP growth rates for both FY2014 and FY2015 would be faster than our potential growth rate. As a result, the inflation target could be naturally achieved.

As a slightly tough question, some other reporters asked whether any delay in raising tax rate could cause any trouble to the QQE (while the delay could rather be beneficial if it could prevent any negative impacts on our domestic demand).

Readers may like to note that there have been intensive discussions whether we should proceed to consumption tax hike as scheduled. Reportedly, the opponents have been concerned about the possible negative impacts on our economy, when we observe some positive signs of exiting deflation. The line of thoughts of proponents would prioritize fiscal consolidation, fearful about fiscal crisis from longer-term perspectives.

At least from the political viewpoint, future course of this important policy agenda becomes uncertain. In fact, Prime Minister Abe requested the cabinet that they should discuss some options and report back to him. These options include "measured pace" hike as well as temporary delay.

Governor Kuroda insisted that the BOJ will be making efforts for achieving the inflation target within two years, regardless of the fiscal policy conducts. While this was a politically correct answer, the BOJ implicitly supports the consumption tax hike already. Because the BOJ expects our economy would grow strongly this year when the government make final decision based on the revised growth rate of the second quarter.

Moreover, as a reply to the related question, he referred to the fact that the joint statement by the BOJ and the Government – which was confirmed when the QQE was introduced – included the commitment by the government to pursue fiscal consolidation.

Finally, Governor Kuroda mentioned about the risk of rising long-term yields if and when the market become concerned about the loss of fiscal discipline or about the fiscal dominance. In fact, Governor explained that possible higher rates of JGBs could undermine the policy intension of the QQE.

According to the press reports tonight in Tokyo, Finance Minister Aso is launching a special standing committee to discuss the consumption tax issue and Governor Kuroda

would be one of the members. Therefore, today's discussion would continue for a while at some different venue.

## Inflation expectation

Some press reporters raised this issue again. Readers may remember that the BOJ faces tough challenge for identifying and/or tracking inflation expectation in an appropriate manner.

From technical viewpoint, even the BOJ admits that the BEI derived from inflation-indexed government bond could contain some distortions due to the problem of market liquidity. More broadly, implied expectation by survey results could also have some problems, simply because we are too much accustomed to deflation for long years.

In spite of these problems, it is crucial both for the BOJ and us to estimate inflation expectation as accurately as possible, since the QQE is intended to achieve the inflation target. And the evaluation of this policy framework should depend on the developments of inflation expectation.

Interestingly, as I mentioned at the beginning of this Note, the BOJ slightly upgraded their evaluation of inflation expectation. A press reporter asked Governor Kuroda to show some specific evidence as a rationale. As expected, Governor's answer was not so clear. He suggested that we should follow a set of indicators that are included in the BOJ's semi-annual outlook and should focus on the trends.

For the purpose of transparency, the BOJ may need to identify some smaller number of indicators that could better track the inflation expectation in our economy.

## External demand

Rest of the time of today's press conference was devoted to the outlook of our external demand. The reporters seemed to be somewhat convinced by the slightly hawkish views on our domestic demand by the BOJ. Still, some of the reporters expressed concerns about the outlook of overseas demand.

Major source of concerns was the lackluster performances of overseas economies. Although Governor Kuroda effectively confirmed that economic recovery of some emerging countries and European countries have been delayed, he reiterated the consensus view among the MPM members that these economies would gradually regain momentum, and the US economy would remain resilient.

A related question was whether any slowdown of exports could prevent positive domestic cycles for economic recovery. While Governor Kuroda referred that the export is now on the gradual increase trend, positive effect of depreciation of JPY on corporate profits would be more significant. Increased profits have led to some increase in wage payment, which may contribute to improving consumer sentiment. It should be noted, however, Governor Kuroda added that it would be too early to judge whether the domestic business investment could also increase.

**Author: Tetsuya Inoue**

**General Manager and Chief Researcher**

**Financial Technology and Market Research Department**

**Nomura Research Institute**

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