

Introduction

Most headlines of the press reports covering today's MPM refer to some further improvement of economic outlook by the BOJ. In the meantime, most of the discussion at today's press conference was related to longer-term policy issues including consumption tax (again). Let me review some of them.

Consumption tax hike

A number of press reporters raised the consumption tax issue, and asked the governor whether he still supports for the original schedule of raising rate.

Readers may like to note that the cabinet office held the intensive series of hearings from the broad range of experts last week, and some 70% of them reportedly expressed support for the original timeframe. Interestingly, Governor Kuroda was also invited to attend these meetings, but as the listener on the government side.

Today, in reply to the questions by press reporters, Governor Kuroda explained his view somewhat clearly that the consumption tax hike itself is a necessary policy action. While he skillfully avoided the explicit discussion on the "probability" of negative reaction in the markets if the policy action is delayed, he referred to the risk of losing confidence by the markets on our fiscal consolidation.

Moreover, Governor Kuroda repeatedly insisted throughout the press conference that the management of economic policy could become extremely difficult, if the markets become concerned about the monetization of fiscal debt. In such a case, according to Governor Kuroda's comment, the government could not utilize the fiscal expenditure. At the same time, the central bank could not maintain stability of interest rates through monetary stimulus.

In my view, these line of discussion was enough to understand the BOJ's fundamental stance on this issue. What Governor Kuroda would like to insist is the we should avoid the risk of the situation as discussed above, even if it is quite uncertain whether a delay in consumption tax hike could trigger the concerns about monetization. This is not only because it would undermine the JGB purchase as the core measure of the QQE, but also the BOJ could face serious challenge to maintain economic stability.

It was also interesting to find that some press reporters seemed to try to draw the comments from Governor Kuroda that it would be better on our economic conditions to raise the consumption tax rate as scheduled rather than being postponed. While Governor Kuroda avoided this controversial issue, it could be the case when some part of private consumption and/or investment depends on the confidence of our fiscal consolidation. Readers, however, may think it would be too naïve to maintain strong confidence in Japan.

Natural rate of interest

A senior press reporter asked Governor Kuroda about the impacts of monetary stimulus on the natural rate of interest and its mechanism. Readers again may like to note the relevant fact. In his speech at Jackson Hole last week, Governor Kuroda implied that the QQE could not only suppress the real interest rate, but also could raise the natural rate of interest. There has been some discussion in Tokyo market on this interesting argument.

Governor Kuroda today insisted that the fundamental venue of monetary policy transmission would be on the real interest rate, and it would also the case with the QQE. Moreover, he emphasized that the economic growth strategy as "Third arrow" in "Abenomics" would play a major role for raising the natural rate of interest. Nevertheless, Governor Kuroda added that the QQE could contribute to raise the natural rate of interest because of our decades-long deflation.

Although Governor Kuroda did not elaborate the above discussion further, he might like to argue that the QQE could remove of deflationary mind, which could result in changing some structural economic factors such as propensity to consume and/or investment. It seems to me that this line of thought would be a core and original idea of the QQE.

QQE: future course

As many economic indicators – those on private consumption, exports, corporate profits and finally labor income and business investment – suggest, Japanese economy is on its gradual recovery course. Nevertheless, it would still be uncertain whether 2% inflation in 2015 is feasible, even if the recent rise in inflation rate.

In light of such inflation outlook, there could be a growing debate on a possible policy action by the BOJ when and if it becomes clear that the inflation target would not be reached as committed.

From the viewpoint of the BOJ which introduced the inflation targeting as its own initiative, it would be reasonable to conduct additional stimulus in a case as above. In fact, Governor Kuroda replied to some press reporters along this line of thought. He of course insisted that the BOJ would enhance monetary stimulus regardless of the nature of downward pressures, and these would not limited to downside economic risks caused by a consumption tax hike.

In any case, such additional stimulus could raise a challenge for the BOJ. If the BOJ would cling to the original strategy of the QQE – "shock and awe" to our economy" – , they need to prepare far larger scale of stimulus. It might not only raise technical issues of monetary operations, but it could also trigger the kind of concerns that we discussed above.

In contrast, if the BOJ would conduct incremental increase in the size of some parts of the QQE, the policy strategy could converge to the Comprehensive Easing under the previous regime. While I think this could still be effective to some extent, organizers of the QQE could feel uneasy whether this could undermine the whole effect of the QQE so far.

It might be too early to discuss this kind of issue when our economy goes well. In light of the external risk factors that the BOJ points in the statement, however, it would still be useful to think in advance.

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