Notes on Financial Markets Vol.68

Press conference by Governor Shirakawa — New framework

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Introduction:

The BOJ's Monetary Policy Meeting (MPM) today attracted so much attention not only by the market participants and the policy experts both in Japan and overseas economies, but also by our general public due to the obvious reason. Their set of decision could have interesting and long-standing implications for policy conducts by the BOJ, although there has been relatively muted reactions in our domestic markets (because they are in line with the market forecasts).

Let me first summarize briefly the outline of today's decisions because they are somewhat complicated. Then, I raise some issues discussed at the press conference today.

Brief summary of today's decision:

As expected, the BOJ introduced the inflation targeting with 2% target. It should be noted, however, the framework appears to be similar to the FRB's rather than to the BOE's. The BOJ commits to achieve the target "as early as possible" without any specific timeframe. Moreover, the policy performance will be reviewed at Council of Economic and Fiscal Policy (CEFP) by the Cabinet Office (probably at the occasions of the regular reviews of the BOJ's outlook).

The BOJ (Governor) and the government (Minister of Finance and Minister for Economy and Fiscal Policy) issued the joint statement. In this document, the BOJ announced to introduce the inflation targeting and explained its general idea of policy conducts. The government announced its intensions to conduct policies for promote economic growth and fiscal sustainability. However, the readers would require more concrete measures by the government.

Last but not least is the additional monetary stimulus, and they are most complicated. The BOJ will manage the Asset Purchase Program (APP) under the new guideline. The BOJ will purchase JGBs with ¥2tn and TBs with ¥10tn. It will also maintain the outstanding amounts of risk assets (CPs, Corporate Bonds, ETFs and REITs) along with lending against pooled collateral. Importantly, this new guideline dose not have any pre-determined terms. This is why the press article may call it "unlimited stimulus". It should also be noted, however, the new guideline will be effective in 2014. Until then, the BOJ maintain the current guideline of the APP.

Point 1: Policy measures toward the target

At the press conference, a number of press reporters suspected that the BOJ could not achieve the 2% target within a meaningful period. In particular, they seemed to believe that the additional stimulus measures announced today would not be so powerful.

While their thoughts would be rational, the BOJ's line of discussion seems to be quite different. As clearly explained by Governor Shirakawa today, the BOJ expects to achieve the inflation target not only by the monetary policy but also by the broad range of economic policy by the government. Looking from their perspectives, the joint statement announces the joint responsibilities by the BOJ and the government.

In this respect, it is interesting to note that Mr. Kiuchi and Mr. Sato opposed to the introduction of 2% target. Readers might have been wondering the reason, especially if the readers know that these gentlemen have been "dovish". As a response to the question by a press reporter, Governor Shirakawa implied that these gentlemen argued that 1) 2% inflation would not be realistic from their point of view, which would be resulting in losing confidence in the BOJ's policy and 2) such high target could not be achieved by the BOJ's monetary policy alone. These views expressed by the gentlemen seem to be rather consistent with the BOJ's conventional stance toward the inflation targeting.

The BOJ would have some reasons for emphasizing their new line of discussion. First, it is rather consistent with their core idea that the our deflation is not only a monetary phenomenon, but also has some roots in our economic structure. More importantly, the BOJ may be aware of the risk of financial instability if the BOJ alone tries to achieve the target only with the monetary policy. Apparently, it would require some drastic measures.

While the first reason could still raise some debates among the economic and policy experts in Japan, the second reason could appear to be persuasive to our market participants.

Nevertheless, the BOJ's line of discussion could become a double-edged sword. Once the government understands and accepts the BOJ's view, they could require closer and more frequent dialogue whenever the additional stimulus is planned by the BOJ, because they could argue that stronger cooperation is needed for achieving the target. In the long run, people could wonder whether it is necessary to respect the independence of the BOJ's policy, if the BOJ could satisfy its mandate of monetary control only partially.

Point 2: Joint statement

Our domestic market participants seem to be rather sober about the joint statement between the BOJ and the government. Probable reason would be that this practice has a preceding case. Readers may remember that Mr. Maehara, former Minister for Economic and Fiscal Policy at the DPJ cabinet required the statement, which was successful.

Another technical but important reason is that it is hard for the government to make commitment with concrete policy measures at this stage. Because of the general election in last December and the change of party in charge of the cabinet, the arrangements of policy agenda for the next annual budget (covering FY 2013 staring in April) is still under way.

In light of the aspects of mutual commitment as discussed in the previous section, the BOJ may like to request to the government to revise the joint statement as soon as the government finishes organizing the next annual budget and could make clearer commitment with some concrete policy measures. It would be an initial job for a new Governor of the BOJ who is expected to be appointed in mid-April.

Apart from its contents and commitments, the joint statement might have already played an important role. Today, after the MPM accepted the joint statement as part of their policy decision, Governor Shirakawa visited the office of Prime Minister Abe. Although Minister Aso (Finance) played a role of submitting the statement to Mr. Abe, Governor Shirakawa and Minister Amari (Economic and Fiscal Policy) were present in font of Prime Minister Abe, according to the press report. When the general public see this photograph in news papers, they may have the impression that the Prime Minister have taken stronger political control over our central bank. We might observe its implication in the long-run.

Point 3: Strength of commitment

Another issue attracted attention by the press reporters was the management of policy commitment. They raised the concerns that the BOJ's commitment might have been weakened , because there is no specific timeframe under the new regime of monetary policy.

The important reason for dropping the timeframe would be related to the above discussion. As Governor Shirakawa implied at today's press conference, the BOJ would like to maintain full discretion on their monetary policy, because the economic policy by the government and their impacts on the trajectory of inflation would be quite unclear at this stage.

As a related issue, the BOJ could not present any timeframe of achieving the target under the simple 2% inflation targeting, because of their new line of discussion in the previous section. As has been reported by our domestic press, 2% target has become a political agenda which could not be avoided because of its "technical" difficulties.

While these factors appear to be reasonable, the BOJ may like to reconsider the introduction of the timeframe for its policy commitment in coming months. As Governor Shirakawa reiterated today, the BOJ is aware of the effectiveness of clear commitment for stabilizing long-term yields. Moreover, unless some clear timeframe, the BOJ could face frequent and persistent pressures for increasing the amount of JGB purchase.

A possible option would be to give some assurance to the markets to maintain the new framework at least until some interim target (at 1% inflation, for example). In light of the political debates, it should be conducted as "verbal guidance". Nevertheless, the BOJ could make such commitment with some confidence. In fact, according to their new economic outlook released today, majority of the policy board expect such interim target to be achieved sometime in FY2014.

Point 4: Foreign exchange rates as policy transmission

One interesting aspect of policy debate is losing momentum of foreign exchange policy. Toward the MPM, several major figures in the cabinet either warned against the risk and costs of excessive depreciation of JPY in a short period of time, or referred to the possible conflicts against our trading partners if the policy appears as the currency manipulation.

As some economic experts warned from the outset of this round of policy debate, the balance of costs and benefits of JPY's depreciation may have been evolved. We have been recording trade deficits not only due to cyclical downturns of the overseas demands. It may be the case that the politicians have heard the voices of concerns from managers of the SMEs whose profits have been hit by the elevated level of price of energy. In addition, in terms of the negative reactions from overseas economies, even the policy experts may have underestimated the impacts.

As a possible result, both the market participants and the politicians started to refer to the trading range of JPY, which could either be sustainable or desirable according to their views. 90-100 Yen per US dollar appear to be their consensus range at least at this stage.

Several points could be raised as its implications:

First, the depreciation of JPY alone could not be a sufficient policy measure to achieve the inflation target. While the depreciation could contribute to accelerate inflation to some extent, its elasticity seems to be fairly small in Japan. Put differently, if we try to achieve the inflation target only by the depreciation of JPY, we would need to have substantially cheap JPY. It may not be feasible in light of the potential costs to our economy and financial system. Moreover, such policy strategy is not consistent with the BOJ's new line of discussion as reviewed in the first section.

Second, the maintenance the stability of JPY rates could still be a meaningful policy even when we could not be able to depreciate them further. Removing the risk of rapid appreciation could provide the opportunities for our firms to adjust their business models to regain competitiveness in the global markets. This is a classic example of economic policy to "buy time".

Third, the new framework of the BOJ's policy – purchasing JGBs and TBs without any pre-determined timeframe since 2014 - could consistently function as stabilizers for JPY rates. For example, the ideas of the management of asset purchase is quite similar to the FRB. While the pace of purchase is currently faster for the FRB, the BOJ's new framework seems to be flexible in accelerating the pace.

Fourth, there is a strong speculation among our financial press that if we could maintain stabilization of JPY rates, criticism on economic policy by firms and households could substantially diminished, even if the rate of inflation remains low. If this is the case, foreign exchange rate could function for policy transmission through improving economic sentiment.

Conclusion

Our new framework of inflation targeting has some unique aspects. Among all, both the responsibility and the policy conducts for achieving the target will be shared by the central bank and the government. Under this framework, the BOJ may try to minimize the risk of triggering instabilities of JGB markets as well as to keep consistency of their idea on deflation. We could identify, however, some elements that could undermine the independence of the BOJ's policy.

All in all, the actual management of the inflation target by the BOJ should be evolving in nature and we should keep our eyes on it.

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