Notes on Financial Markets Vol.78

Press conference by Governor Kuroda — Recovery on track

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Introduction

The BOJ largely maintained their semi-annual outlook today as expected. Moreover, with the volatility of JGB yields contained, there appeared to be less policy debates at today's MPM. Nevertheless, let me focus on some interesting issues raised at the press conference.

Point 1: Recovery

A number of press reporters highlighted the fact that it is the first time since 2010 that the BOJ evaluates that our economy is recovering. Governor Kuroda mentioned that the MPM members decide to use this specific word, because they are confident about the autonomous improvements of economic activities as a whole.

As an important background, the results of most recent TANKAN survey seemed to play the role. It is because the results showed some signs of improvements of the sentiments among managers of Japanese corporations. Moreover, the plans of business investment for this fiscal year, as the aggregate view, implied a good start for now.

It should be noted that gathering momentum of economic activities of corporate sector may be most encouraging to the BOJ. In fact, we observed the diversified dynamics of economic recoveries between private consumption and business investment until recent months. If and when the corporations join the consumers in expanding the activities, it would of course be reasonable for the BOJ to declare that our economic recovery has firm footing.

It should also be noted that the BOJ may not be too optimistic. The MPM members described the recovery is moderate, and Governor Kuroda admitted that there remain substantial uncertainties in overseas economies. While the BOJ maintained their main scenario of economic growth, they are aware of the tail risk. As discussed in my previous Note, the BOJ could face considerable trouble when it is required to introduce the additional monetary stimulus. We wish every overseas policy maker conduct appropriate policy measures.

Point 2: Inflation expectations

Another focus of the discussion at today's press conference was the evaluation of inflation expectation. This was quite reasonable, because generating the positive rate of inflation expectation is the core idea of the QQE by Governor Kuroda. As a result, any success of the QQE could be evaluated by the performances of inflation expectation.

Nevertheless, as discussed in my previous Note, tracking inflation expectation is technically challenging. In line with the diversified economic activities, inflation expectation by consumers and managers of corporations seems to be diversified at least until now. Moreover, inflation expectation by consumers, which have shown remarkably positive reactions to the QQE, strangely started to lose momentum (with stock price movements).

As for inflation expectation in financial markets, the task of estimation becomes tough. We do not have a liquid market for inflation indexed note to estimate BEI. The market liquidity of other derivatives markets relevant for estimating inflation would not be sufficient, either. The problem may be crucial for our case, because the participants in some market segments would be most skeptic about the effects of the QQE.

As a policy strategy, it may not be better for the BOJ to go further into the technical details of estimating inflation expectation. The BOJ would rather pay more attention to the prospects of economic growth, because inflation expectation as the macro-economic indicator would be substantially affected by the GDP gap.

This line of discussion has an important implication to the policy strategy of the QQE. We all remember that Governor Kuroda insisted that our inflation expectation could be calibrated by the announcement of the QQE. It was true, however, in the first phase of the QQE. When and if the QQE is finishing the first phase, inflation expectation would be more affected by the balance of aggregate demand and supply. And much larger number of observers including some cautious players of the financial markets could see the mechanism more acceptable, even if the expected trajectories of inflation expectation could be much less spectacular.

Point 3: Forward guidance

As it might appear strange to the overseas readers, there has been a discussion that the BOJ should follow the global trend of introducing a forward guidance. Readers would already be aware that the BOJ maintains its forward guidance as an important pillar of the QQE. In fact, the BOJ announced that it will continue to conduct the QQE until the CPI inflation is stably above 2%.

Possible reason of confusion is that the BOJ's current forward guidance under the QQE is addressing the quantity of funds rather than the policy rate, as raised today by a reporter of the economic journal. Under the normal conditions of money markets, commitment in maintaining very large amount of excess reserves could have mostly equivalent impact to maintaining zero interest policy rate.

One possible point of difference would be the effects on the volatilities of short-and/or medium-term interest rates. The effects of a forward guidance of the policy rates were evidenced by the previous case of "time commitment" by the BOJ. In contrast, the effects of a forward guidance of the quantity of funds may need to be tested, in light of our experiences during the past few months.

As one implications of this line of discussion, a forward guidance of a policy rate could be utilized as a measure for macro-financial purposes. A relevant case would be the "tapering-off" of the LSAP coupled with a forward guidance of the policy rate by the FRB. Even if the upward movements of the yields would be inevitable, unnecessary volatilities should be minimized. For our financial system, we could test this measure when the JGB rates become volatile again.

Author: Tetsuya Inoue
General Manager and Chief Researcher
Financial Technology and Market Research Department
Nomura Research Institute