

Introduction

I would like to criticize the thoughtless market talk that the Monetary Policy Meeting (MPM) today would be a “throwaway match”. In fact, Ms. Shirai, Member of the Policy Board raised the important issue for the policy strategy in coming months. Moreover, Governor Shirakawa expressed his ideas against future challenges in a thoughtful manner.

It is the last regular press conference for Governor Shirakawa. Let me discuss some of his points with sincere respect.

Quantitative aspects of the BOJ's policy

Large number of press reporters tried to draw some comments both on the official candidates of new Governor and Deputy Governors as well as their policy ideas. It was fully anticipated, because we observed their confirmation hearings in the lower house of the parliament several days ago. And as expected, Governor Shirakawa declined to make any comment.

Nevertheless, Governor Shirakawa insisted the boldness of current framework of the BOJ's policy especially in its quantitative aspects. He reiterated the fact that the aggregate amounts of liquidity injection in CY2013 would become as large as ¥50tn. Moreover, he explained that the current account balance at the BOJ at the end of December this year would become ¥85tn according to the staff estimate.

It should be noted that Governor Shirakawa effectively implied the current account balance would be twice as large as its current level. At the same time, the BOJ expects that the core CPI inflation rate would only be 0.9% on annual basis in FY2014, according to their most recent outlook.

Readers may like to recall that Professor Iwata, the official candidate of Deputy Governor has been claiming that the current account balance should be doubled in order to exit from our chronic inflation. It is ironic to find that even Professor Iwata's proposal may not be bold enough to achieve the inflation target, taking account of the current framework of the BOJ policy and their staff estimates.

It may be possible that new Governor and Deputy Governor could be frustrated to the small elasticity of our inflation rate to the liquidity injection by the BOJ. In light of the feature of our financial markets, the only viable instrument for massive liquidity supply would be the JGBs. Then the focus of attention would be shifted toward the management of JGB operations.

Management of JGB operations

There are reasons for press reporters to raise this important issue. Ms. Shirai, Member of the Policy Board proposed to integrate the operations under the APP and those as the Rinban. Furthermore, it is highly probable that the BOJ under new Governor would increase the amount of JGB purchase in an accelerated manner.

Most of the questions today regarding the JGB operations could be categorized into two representative ones. First, what would be the definition of monetization by the BOJ? Second, what could be the safeguards against such risk?

In response to the first question, Governor Shirakawa insisted that the intension is the key condition. In other words, if the government bond purchase is conducted as monetary policy to pursue the price stability, it should not be criticized as monetization of fiscal deficits.

With regard to the second question, Governor Shirakawa expressed doubt about any numerical or quantitative conditions. He also insisted that the Banknote rule is intended to separate the different kinds of JGB operations; Rinban operation as long-term ALM and the JGB purchase under APP as unconventional monetary policy. All in all, he emphasized the BOJ's position that both kinds of operations have been conducted as monetary policy.

His line of discussion appears reasonable and consistent with the conventional idea of central banking. Nevertheless, as a press reporter claimed, it is highly uncertain whether the idea of the policy intension would effectively protect a central bank from involving in monetization. As a worse scenario, a central bank might like to cheat the markets and the public by making a false claim that it is intended as monetary policy.

While we are fully aware that identifying the optimal conditions would not be an easy task. This is largely because the situation of monetization would depend not only on the framework of a central bank's operation but also on the external factors including the structure of government bond holdings, the functions of financial markets, the fiscal discipline and the market sentiment. Nevertheless, we should seek second best conditions in light of the magnitude of the risks.

Japan with 2% inflation

As a reply to the question about the timing of achieving the inflation target, Governor Shirakawa suggested the four cases of Japanese economy with 2% inflation.

First, inflation is driven only by the depreciation of JPY and/or the rise in import prices. Governor Shirakawa explained that it is not desirable, because the real income of household would be seriously hurt. Second, inflation gets faster only by the rise in wages, Again it is not desirable, according to Governor Shirakawa, because it would squeeze corporate profits. Third, inflation is accelerated by inflation expectation (sometimes called as second-round effect). Governor Shirakawa implied this is worst, because the government bond prices could plunge. Fourth, inflation is brought about by expectation of higher economic growth. He explained this is the best of all.

Governor Shirakawa also mentioned that it would be the actual case that some of the above conditions would materialize simultaneously. There might be some suspicion about this benign scenario, however, taking account of the differences in speed of adjustment between the financial markets and the real economy. Among the four cases, first and third would function through the financial markets, while second and fourth would work through the adjustment processes in the economy.

This kind of concern would be another reason to have some conditions by the BOJ to prevent exaggerated reactions in financial markets for the concerns about monetization.

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