

Where would BOJ's new monetary policy settle down?

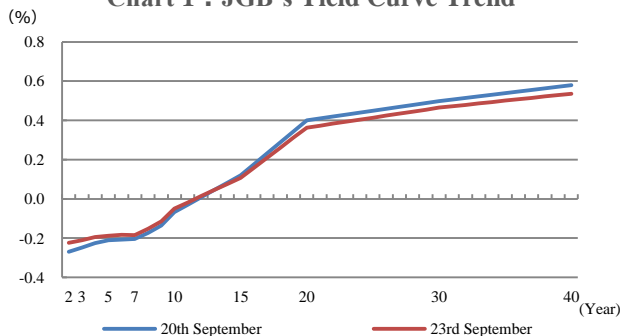
- It is difficult for BOJ to control both “interest rates” and “quantity” at the same time. If BOJ aims to proactively control “interest rates”, control of “quantity” will be given lower priority.
- Mechanism of raising inflationary expectations by “inflation-overshooting commitment” seems to need more deep analysis.
- Credibility of BOJ's new policy rests on how successful this “Yield Curve Control” turns out, though raising inflation seems quite challenging.

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“Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control” was introduced by BOJ on 21st September 2016. The new policy framework consists of two components; (i) “yield curve control” and (ii) “inflation-overshooting commitment” for continuing quantitative easing until price stability target is decisively achieved. However, it seems difficult for BOJ to operate both (i) and (ii) at once, as BOJ Governor Kuroda himself stated that the pace of increase in the monetary base (“quantity”) may fluctuate under implementation of yield curve control (“interest rate”).

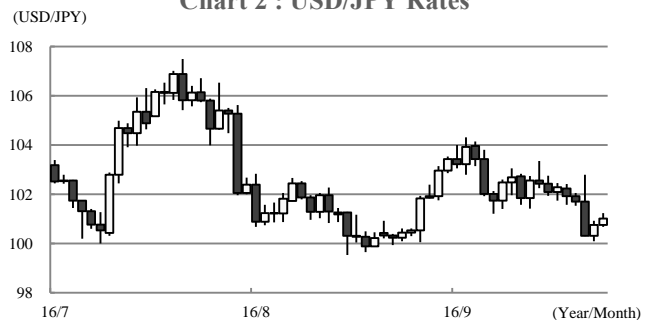
As long as BOJ aims to proactively control “interest rates”, control of “quantity” should become passive. In fact, there was no concrete commitment of pace of quantitative easing by BOJ, despite its statement to continue expanding the monetary base until YoY rate of increase in the observed CPI exceeds the price stability target of 2% and stays above the target in a stable manner, in its “inflation-overshooting commitment”. Therefore in an extreme case, BOJ may still meet its commitment as far as monetary base increases even by amount of JPY 10 trillion per year, which used to be about JPY 80 trillion in the past.

“Chart 1 : JGB's Yield Curve Trend”



(Note) Yield of i) 10 years to 15 years, ii) 15 years to 20 years and iii) 30 years to 40 years are based on time distribution.
(Source) SMAM, based on Bloomberg L.P. data.

“Chart 2 : USD/JPY Rates”



(Note) Data period is from 1st July 2016 to 23rd September 2016.
(Source) SMAM, based on Bloomberg L.P. data.

Mechanism of raising inflation expectations by “inflation-overshooting commitment” seems to need more deep analysis

We do not expect pace of monetary base increase to sharply slow down immediately. However, decrease in BOJ’s JGB purchase amount is possible as long as bond market remains stable as pace of purchase becomes flexible going forward. Therefore, we believe monetary base expansion (“quantity”) will become relatively less important in future. However, “Yield Curve Control” itself is not easy to implement (Chart 1). We expect BOJ will make adjustments in yield curve operation after October by analyzing market reactions.

Meanwhile, BOJ reiterated its view that rise in inflation expectation rate is essential for achieving the price stability target of 2%, in its comprehensive assessment result announced on 21st September 2016. Accordingly, afore-mentioned “inflation-overshooting commitment” was introduced and period of monetary easing was lengthened from “until when 2% increase (YoY) in the observed CPI can sustain in a stable manner” to “until YoY rate of increase in the observed CPI exceeds the price stability target of 2% and stays above the target in a stable manner”. However, more deep analysis is required as there is no explicit explanation on mechanism of raising inflation expectations.

Credibility of BOJ’s new policy rests on how successful this “Yield Curve Control” turns out, though raising inflation seems quite challenging

As to USD/JPY rate, JPY temporarily strengthened against USD to 100.10 level on 22nd September 2016 (Chart 2). USD weakened as Federal Open Market Committee (FOMC) indicated moderate pace of interest rate rise going forward by postponing it on 21st September 2016. Meanwhile, we think JPY has not weakened as market is not confident of BOJ’s new monetary policy framework as it is still not clear whether inflation will rise in Japan or not.

It must be noted that monetary policy adopted this time has to be considered as a policy mix with fiscal policy. Lengthening the period of monetary easing and “yield curve control” are expected to offset rise of interest rate and JPY (crowding-out effect). However, we think both stock market and currency market will pay more attention on yield curve going forward, since BOJ emphasized “yield curve control” as a pillar of its new monetary policy. We therefore think credibility of BOJ’s new policy rests on how successful this “Yield Curve Control” turns out.

*** Please note that this report is a translation of Japanese report written on 26th September, 2016.**

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