Notes on Financial Markets Vol.269

Implications of the lower house election on economic policy

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Introduction

The BOJ decided to maintain its policy rate at 0.75% in March MPM with one dissent vote. Governor Ueda explained that the central scenario of economy and prices remain unchanged, but its level of confidence deteriorated.

Assessment of economy

Governor Ueda reiterated the constructive view of underlying activities. The policy statement confirmed the gradual growth in business investment and the resiliency of consumption on the back of improved earnings. Looking forward, Governor Ueda also maintained the gradual recovery path..

Nevertheless, Governor Ueda insisted the high uncertainties due to extensive rise in energy prices recently. He explained that deterioration of terms of trade would affect economic activities, especially in Japan that depends heavily on external sources of energy.

During the Q&A session, many reporters asked the potential magnitude of shocks to the economy. Governor Ueda insisted that the magnitude remained uncertain as it considerably depends on the width and duration of the rise in energy prices. Nevertheless, he expressed the view that the risk of stagflation remained low at least for now.

Assessment of prices

Governor Ueda maintained the constructive outlook of the underlying inflation while he admitted that headline inflation decelerated toward 2% due to the policy measures to contain prices. Looking forward, the policy statement confirmed the view that virtuous circle between wages and prices would continue and the long-term expectation of inflation would keep improving.

Regarding the impacts of rising energy prices, Governor Ueda expressed the vigilant view with the forecast of hitting the bottom of headline inflation rate in coming months.

During the Q&A session, number of reporters asked whether supply side shock or temporary shock would affect the underlining inflation. Governor Ueda explained that the evolution of inflation expectation would be the key factor for the judgement. Moreover, he referred to the view that the pricing behavior of firms changed substantially in recent years, suggesting that the risk of the second-round effect would not be negligible.

Interestingly, some other reporters asked the effects of further gradual depreciation of JPY recently. While Governor Ueda avoided to make comment of the evolution of JPY rate, he reiterated the view that the sensitivity of domestic prices or the underlying inflation to import prices appeared to increase.

Readers may also like to note that the pressures for deprecation of JPY may become stronger and sustained, if the potential deterioration of current account due to higher energy prices becomes additional factor for JPY rate.

Other reporters asked the momentum of the annual wage revision. While Governor Ueda explained that high rate of increase has been agreed among large firms, it remained uncertain whether it would also the case with SME. Accordingly, he mentioned that the BOJ would collect the relevant information from their contacts among SMEs.

Decision of policy rate

The MPM in March decided to maintain the policy rate unchanged with one dissent vote claiming that the inflation target was effectively achieved. Readers may like to note that there were also two dissent votes on the outlook, because of their bullish views of the underlying inflation.

The policy statement maintained the existing strategy that the BOJ would adjust the magnitude of monetary accommodation as long as the evolution of prices and economy remains on track of their outlook.

During the Q&A session, focus of attention was the assessment of balance of risks between downside risk of the economy and upside risk of the underlying inflation..

Governor Ueda suggested that it was too early to judge as the situation of Middle East and the outlook of energy prices remained highly volatile. Moreover, he suggested another downside risk if the supply chain of broader based goods is disrupted. On the other hand, simple strategy of look-through against supply shock may be irrelevant as underlying inflation has been on the upward trend.

All in all, Governor Ueda expressed the perception that modestly larger number of the MPM members suggested that upside risk of inflation was more important.

Governor Ueda also insisted that the assessment of the magnitude and plausibility of risks would be more important than the central scenario itself, when the BOJ would conduct the quarterly review of the outlook in April.

Decision of policy rate

Governor Ueda reiterated the idea that There is no simple indicator of the underlying inflation, and its should be judged by multiple indicators. Nevertheless, he admitted that it remained difficulty to share the evolution of the underlying inflation with the market.

Readers may like to note that the government had intended to decrease consumption tax rate on food staff for two years in order to support real purchasing power. Moreover, in light of sudden and large rise in energy prices, they discuss some additional measures to contain retail energy prices. As they are contingent in nature, the impacts on headline inflation would also be temporary as the level effects.

Governor Ueda explained that these policy effects would make sharing the proper understanding of the underlying inflation further complicated. Accordingly, the BOJ would release some indicators of the underlying inflation excluding the policy effects. It could have technical challenges, however, indirect impacts of the policies to contain energy prices would become broader over a range of services.

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