

Daiwa's View

Speech by BOJ board member Goushi Kataoka and equilibrium yield curve

- What is a more accommodative equilibrium yield curve?

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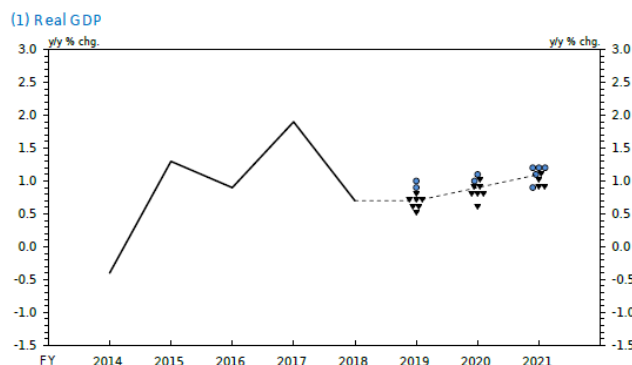
What is a more accommodative equilibrium yield curve?

On 4 September, a speech by BOJ board member Goushi Kataoka was released. First, we confirm his economic recognition based on the speech. Compared to the BOJ's consensus and the *Outlook for Economic Activity and Prices* report (*Outlook* report), he has a dovish (bearish) view as a whole. Regarding overseas economics, he opined that "a recovery of the global economy was expected from the latter half of this year, but the possibility is increasing that the timing will be delayed and the degree of rebound will remain small" due to greater uncertainty about the economic policy, escalating US-China trade tension, and a delayed recovery of the global semiconductor market.

With respect to Japan's economy, he stated that "the possibility is high that exports will remain sluggish and the capex growth trend may let up." Although private consumption has been supported by a favorable employment environment, he pointed out signs of changes in the labor market as witnessed by the y/y decline in the number of available jobs as well as consumer sentiment worsening more than in the previous consumption tax hike case.

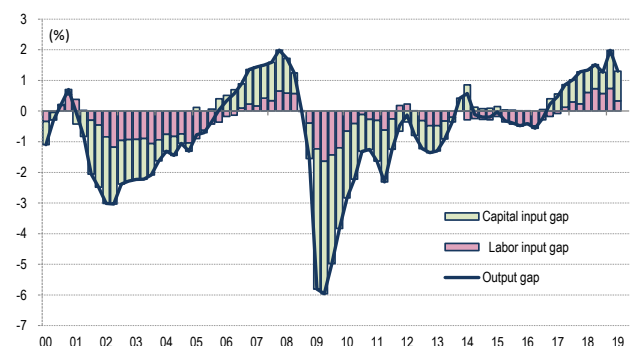
Based on these outlooks, Mr. Kataoka projects that the GDP growth rate during FY19-21 will be in the mid- to upper 0% range, slightly lower than the potential growth rate. He also clearly stated that risks are skewed to the downside. This is a bearish view in comparison with the BOJ's main scenario (*Outlook* report) in which the GDP is projected to continue to increase in line with the potential growth rate.

Chart: Policy Board Members' Risk Assessments in Economic Projections



Source: Extract from BOJ Outlook report.

Chart: Output Gap (estimated by BOJ)



Source: BOJ; compiled by Daiwa Securities.

Therefore, he stated that “it has become difficult for the degree of the positive output gap to continue to widen. In addition, inflation expectations have been somewhat weak.” He thus advocated additional easing, saying that “it is appropriate for the BOJ to take action to widen the positive output gap further via additional easing.”

He also pointed out the importance of pre-emptive policy responses—“instead of waiting until we confirm that the price trend (lagging indicator) has changed,” especially in the situation where downside risks on the economy and prices are mounting. Due to this remark, we confirmed that the following opinion in the *Summary of Opinions at the Monetary Policy Meeting* (MPM) on 29-30 July 2019 was submitted by Mr. Kataoka.

◆ **Summary of Opinions at the Monetary Policy Meeting (29-30 July 2019)**

- At this point, it is important to make a preventive and preemptive policy response to downside risks to prices. It is necessary to further strengthen monetary easing through both yield curve control and forward guidance.

Regarding additional easing, he presented a concrete method of a further reduction in the short-term interest rate (deepening of negative rate), as he advocated at the July MPM¹. At a press conference after yesterday's speech as well, he said that “a cut to the short-term interest rate is the most effective for the economy and prices.”

◆ **BOJ board member Goushi Kataoka (4 Sep 2019)**

- If I keep the current flat yield curve in mind, I think it is appropriate to control the yield curve with a view to making the shape of the yield curve more accommodative via a further reduction in the negative short-term policy interest rate.

What is a more accommodative shape of the yield curve? Here, we explain Mr. Kataoka's logic on additional easing. The current flat yield curve is less accommodative than the equilibrium yield curve that is based on his definition. As this prevents the positive output gap from continuing to widen, he appears to be aiming to achieve the “more accommodative shape of the yield curve” by lowering the short-term yield curve below the equilibrium yield curve (real interest rate, which is neutral to economic conditions)².

A report on the concept the equilibrium yield curve by BOJ staff³ also explains that “if the actual real yield curve lies below the natural yield curve (and if yield curve gap is negative), financial conditions are accommodative, leading to improvement in the output gap. ...Heightened uncertainty regarding future economic conditions will lower the natural yield curve.”

Longer interest rates have declined, factoring in growing downside risks to the economic outlook. Meanwhile, the short-term rate could not decline as it is fixed at -0.1% due to BOJ policy, leading to the flattening of the yield curve.

Keeping this in mind, it is necessary to widen the output gap with a view to making the shape of the yield curve more accommodative via a further reduction in the negative short-term policy interest rate. This appears to be Mr. Kataoka's logic.

That being said, “as this is Mr. Kataoka's opinion, it is not shared among board members at the moment” as BOJ governor Haruhiko Kuroda stated at the post-MPM press conference in July. In addition, the “stock effects” due to the BOJ's JGB purchases have been making a substantial contribution to the current flattening of the yield curve⁴. Given this fact, we need

¹ Statement at Jul MPM: Mr. Goushi Kataoka dissented, considering that it was desirable to strengthen monetary easing by lowering the short-term policy interest rate.

² Although he did not use “equilibrium yield curve” in speech, he remarked that “in judging whether the shape of the yield curve is accommodative, we use the three points of level, slope, and deflection” at press conference. This implied equilibrium yield curve.

³ Kei Imakubo, Haruki Kojima, Jouchi Nakajima (Jun 2015). [The Natural Yield Curve: Concept and Measurement](#) (Bank of Japan Working Paper Series).

⁴ Nao Sudo, Masaki Tanaka (Oct 2018). [Do Market Segmentation and Preferred Habitat Theories Hold in Japan?: Quantifying Stock and Flow Effects of Bond Purchases](#) (Bank of Japan Working Paper Series).

to be careful about the logic that the shape of the yield curve is reflecting all economic signals in the market.

However, the BOJ governor and deputy governors have been explaining that the basic mechanism of monetary easing is to lower the real interest rate (yield curve) below the equilibrium yield curve (yield curve). Recently, board member Hitoshi Suzuki who objected to Mr. Kuroda and additional easing also explained the mechanism of the current monetary easing, saying that “policy effects would be exhibited via the real interest rate and premiums of asset prices.” In that sense, what Mr. Kataoka is advocating is in accordance with the correct policy logic.

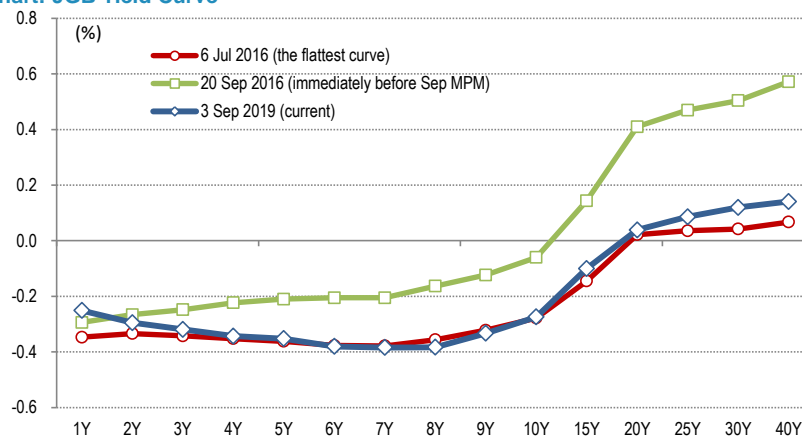
◆ **BOJ governor Haruhiko Kuroda (30 Jul 2019)**

• We will consider additional easing, assuming that the framework of the current “QQE with yield curve control” will continue. Policy effects would thus be continuously exhibited mainly via premiums of the real interest rate and asset prices. We think that we have additional measures in many forms.

Of course, we understand the logic that a further yield decline from the current level can be justified in terms of the equilibrium yield curve but it cannot be justified in light of the reversal rate (side effects)⁵. Therefore, the BOJ is persistently repeating that “we will respond to circumstances of the moment by comparing additional easing’s benefits (merits) with side effects (demerits), as Deputy Governor Masayoshi Amamiya stated.

As the equilibrium yield curve and reversal rate are variable and rely on economic and financial system conditions, we hope that the BOJ will explain the “pros and cons” of additional easing by using the common benchmarks—whether (1) the current yield curve is more economically stimulative than the equilibrium interest rate or (2) a further yield reduction will be unacceptable in terms of the reversal rate

Chart: JGB Yield Curve



Source: Bloomberg; compiled by Daiwa Securities

⁵ Refer to our 28 Aug report [Daiwa's View: Will BOJ also conduct additional easing?](#)

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[Standard & Poor's]

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