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CENTRAL BANKS: MOSTLY WATCHING, BUT READY TO ACT

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A few central banks have loosened monetary policy in recent months, but the majority have decided to stand pat. It took two attempts for the decision makers on the Bank of England's (BoE) Monetary Policy Committee (MPC) to be convinced that Brexit is a non-issue for everyone but the UK. When UK data plunged, BoE Governor Mark Carney rolled out the big guns: £70 billion in asset purchases (£60 billion in government bonds and £10 billion in corporate bonds) and a 25-basis-point reduction in the bank rate.

In comparison with the BoE, the recent policy responses from the European Central Bank (ECB) and the Federal Reserve were tame affairs. The Federal Open Market Committee released a statement acknowledging the improvement in the growth data, and ECB President Mario Draghi suggested that the measures announced at the March meeting were still working their way through the system. So, no more sugar for now.

Anticipation grew in the runup to the Bank of Japan's (BoJ) August policy meeting. Markets pondered every possibility, from Governor Haruhiko Kuroda doing nothing to the Bank of Japan switching to a strategy of outright debt monetization (helicopter money). Speculation about the latter was fueled by talks about increased coordination between the fiscal and the monetary authorities. Eventually, consensus settled on increased purchases of equities and a reduction in the Bank of Japan deposit rate to -20 basis points (a cut of 10 basis points).

The BoJ disappointed and delivered only on the asset purchase segment (exchange-traded fund purchases were increased by ¥3 trillion to ¥6.3 trillion). In addition, Governor Kuroda ordered a "comprehensive assessment" of the efficiency of the central bank's monetary policy framework. What can we expect from this comprehensive assessment? Post-meeting speeches by Board members of the BoJ have suggested that there were extensive discussions at the policy meeting about the desirability and efficacy of negative interest rates. In Japan, a nation of savers, negative interest rates have been met with widespread discontent, in particular among the commercial banks whose earnings are hit by them.

In my view, the comprehensive assessment will produce a document to end the discussion among Board members about the efficiency of negative interest rates. The document will "prove" to everyone that the BoJ is doing the right thing, that it has been diligent and rigorous in its evaluation process, and that negative interest rates are a net positive for the economy. This should free Governor Kuroda's hands should he want to reduce interest rates further in the future.

Could the comprehensive assessment unveil a structural change to the BoJ policy process like a shift to price level or nominal gross domestic product targeting? Unlikely. My guess is that, based on the comprehensive assessment, future monetary policy initiatives in Japan will rely more heavily on policy rate reductions. It is also conceivable that the comprehensive assessment produces a mechanism through which the BoJ could alleviate a nascent shortage of Japanese government bonds (say, through a reverse repo facility).

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