



**The Bank of Japan's "*Outlook Report*" and the Short-Term Outlook for Monetary Policy
and the Markets
– The End of "Monetary Easing" May Not Be in Sight but "Fine-Tuning" Remains a
Possibility –**

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Overview

In its *Outlook for Economic Activity and Prices* ("*Outlook Report*"), published on April 28, the Bank of Japan adjusts its forecast of consumer prices for fiscal 2005 downwards as compared with fiscal 2004, and predicts a small rise for next fiscal year. These forecast values are largely in line with earlier published observations and are consistent with the current consensus among private sector forecasts.

However, uncertainty is growing over the validity of the factors on which the Bank of Japan bases its economic and price forecasts for the coming fiscal year. The growth of overseas economies factor is already showing signs of a possible downturn, and, given past trends and the scale of profit growth expected, there is no knowing whether strong business results will indeed spread to all sectors.

At the same time, this latest *Outlook Report* contains new material, including (i) a summary of the effects of "quantitative monetary easing", (ii) a positive assessment of the fact that, in respect of Bank of Japan funds-supplying operations, the amount of bids is often less than the amount of funds due to be provided, and (iii) a clear indication of the possibility that quantitative monetary easing will be discontinued in fiscal 2006. Overall, while the Bank of Japan does not intend to abandon quantitative monetary easing in the immediate future, the object of the *Report* appears to be to secure the freedom to "fine-tune" policy, for instance, by controlling "excessive elongation of market timescales", "lowering" targets for current account balances, and "temporarily tolerating downturns".

At a press conference given directly after the publication of the *Report*, Governor Toshihiko Fukui told reporters in explicit terms that the Bank of Japan would "maintain the framework" of quantitative monetary easing and that "fine-tuning" of the policy was a possibility. It is thought highly likely that some kind of fine-tuning of the present policy of quantitative monetary easing will take place as early as May or June, when the mood of funding shortfall in the markets strengthens.

The markets have already taken account of indications of the possibility that the Bank of Japan will discontinue quantitative monetary easing next fiscal year and that the policy will be fine-tuned at an early date, and, if anything, are more strongly influenced by low confidence in the economy owing to the dull performance of economic indices in recent months and the bearish trend of share prices. The date at which the futures markets anticipate that quantitative monetary easing will be discontinued has been put back to "around the end of fiscal 2006" and, for the time being, the "dead calm" in short-term market interest rates seems likely to continue. Moreover, in recent years, long-term interest rates have been influenced to an increasing extent by the view on interest rates of

the short-term markets. Given the relationship between the two in recent years, it seems probable that there is limited scope for a further fall in long-term interest rates, and that, even if long-term rates were to begin to rise, their ceiling in the immediate future is around 1.6%.

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