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Bank of Japan's Inflation Targeting

- An inflation targeting is introduced by a number of central banks as a price stability objective.
- Bank of Japan strictly conducts its inflation targeting, but achieving 2% around 1H 2016 seems tough.
- It is not strange that Bank of Japan amends the timing of achieving the inflation target rate to a mid-to-long term in future as other central banks

An inflation targeting is introduced by a number of central banks as a price stability objective

An inflation targeting is a monetary policy in which a central bank has an explicit target for the annual rate of inflation. In general, a monetary policy by a central bank is primarily aims "to fulfill a sustainable growth of economy of the country with stable prices." A Central bank that introduces an inflation targeting should conduct its monetary policy so that an actual increase of prices stays within the inflation target range. As a stable increase in prices reduces the uncertainty of future price fluctuations, companies and household are more easily able to make an investment plan for a long term. If a risk of an investment decision reduces, this leads to an increase in a probability of a sustainable growth of a country. Stable prices are hence extremely important for a monetary policy.

Currently, an inflation targeting is introduced by a number of countries. In history, New Zealand introduced the policy first in the world in 1990, followed by Canada in 1991, UK in 1992, and Australia & Sweden in 1993. Japan later employed it in 2013 as a "price stability target". Yet, although central banks in US and Euro zone have not clearly declare to employ an inflation targeting, US Fed noted in its statement regarding the "longer-run goals" and monetary policy strategy that the Federal Open Market Committee (FOMC) judges that "inflation at the

"Table 1: Comparison of Inflation Targeting Among Central Banks"

	Reserve Bank of New Zealand	Bank of Canada	Bank of England	Reserve Bank of Australia	The Riksbank (Sweden)	Bank of Japan
Year of Introduction	1990	1991	1992	1993	1993	2013
Benchmark	CPI	CPI	CPI	CPI	CPI	Core CPI
Target Rate	1-3%	2%(±1%)	2%(±1%)	2-3%	2%(±1%)	2%
Timing	Medium term	generally 18-24months	Within reasonable term (medium term)	Medium term	Normally 2 years	Approx. 2 years as soon as possible

(Note) As of May 27, 2015. CPI is a headline CPI. Core CPI for Bank of Japan is CPI excuding food and energy.
The are two views of the year of introduction for Reserve Bank of New Zealand. One is Minister of Finance of the country announced an inflation target in 1988, the other is the government and the bank closed the agreement on the inflation targeting.
(Source) SMAM, based on Bloomberg L.P. data.

rate of 2 percent (as measured by the annual change in the price index for personal consumption expenditures, or PCE) is most consistent over the longer run with the Federal Reserve's statutory mandate.” Whereas ECB states to “aim at a y-o-y increase in Consumer Price Index (CPI) of below, but close to, 2% over the medium term as a quantitative definition of price stability.”

Bank of Japan strictly conducts its inflation targeting, but achieving 2% around 1H 2016 seems tough

The Table 1 above shows a comparison of inflation targeting among countries. It is only Bank of Japan that explicitly states a timing of achieving an inflation target rate and strictly conducts its monetary policy. The bank announced on April 4th 2013, “The Bank will achieve the price stability target of 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI) at the earliest possible time, with a time horizon of about two years.” Subsequently, in the “Outlook for Economic Activity and Prices” of April 30th 2015, the bank showed its view, “Although the timing of reaching around 2 percent depends on developments in crude oil prices, it is projected to be around the first half of fiscal 2016, assuming that crude oil prices will rise moderately from the recent level.” However, achieving the inflation target rate seems very difficult at the moment.

It is not strange that Bank of Japan amends the timing of achieving the inflation target rate to a mid-to-long term in future as other central banks

Although in my opinion the Bank of Japan does not have to stick to the timing of achieving the target excessively, Governor Haruhiko Kuroda will hardly amend the bank’s policy on the timing as he believes a clear commitment on the timing should be a vital measure for exiting from a deflationary economy. However, these days many central banks that employ an inflation targeting conduct their monetary policy in a flexible manner even if prices currently deviate from their objective or target range, and clearly express to aim at stable prices and a sustainable growth in a medium term. In other words, the position of an inflation targeting is likely to be shifting from a strict objective to a reference value of enhancing transparency of a policy operation by a central bank. Therefore, it is not strange that Bank of Japan amends the timing of achieving the inflation target rate to a mid-to-long term in future as other central banks deal with it more flexibly. In addition, the bank should not hesitate to consider the amendment as the CPI y-o-y growth rate is likely to get out of a declining trend right now.

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