Daiwa's View

Policy to remain unchanged amid central bank personnel shifts

- Jul *Outlook Report* to maintain recovery scenario, despite great uncertainty

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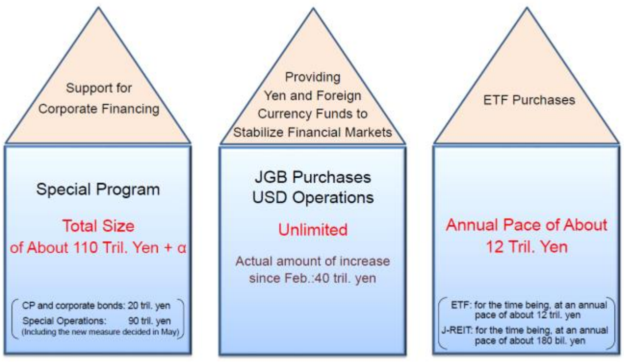
BOJ's personnel transfer dated 20 Jul became market topic, but expected despite pandemic-related delay

The market topic in the morning of 13 July was the announcement of the BOJ's personnel shifts dated 20 July. Since promotion of BOJ Nagoya branch manager Tokiko Shimizu as the first female executive director on 11 May, director general-level personnel shifts (to appoint her successor) have been expected. Under ordinary circumstances, the BOJ's annual major personnel transfer is conducted in June. This year, however, the call to refrain from non-essential cross-prefectural travel amid the COVID-19 pandemic was not lifted until 19 June. Therefore, the personnel transfer was delayed. Seiichi Shimizu, who will become the director general of the Monetary Affairs Department, has been working as director general of the Financial Markets Department for about four years since June 2016. As the BOJ decided to introduce the yield curve control (YCC) policy on 21 September 2016, Mr. Shimizu has been taking various measures to establish confidence for YCC, being involved in the establishment of the YCC framework and struggling with communications with the market. Recently, he had a key role in discussions on measures to enhance the provision of dollar liquidity among six major central banks (decided in Mar), which was one of his major accomplishments.

Change in director general does not lead to revision to policy at organizationally operating central bank

I was asked by many people whether BOJ policy would change due to the change in director general. However, policy will not change at an organizationally operating central bank, except for the case of a change in governor. Moreover, we think that crisis responses to the pandemic should remain the same, regardless of who is in charge. At the 16 June Monetary Policy Meeting (MPM), the BOJ provided reference materials presenting the three pillars of its monetary policy using a simple diagram (Chart 1). However, this diagram includes some measures that were already in place before the outbreak. Also, the BOJ provided numerical upper limits in order to make its measures seem more impressive, but these limits deviate from reality. We were left with the strong impression that the BOJ wants to demonstrate that it is acting decisively. The change of executive director in mid-May appears to have had an impact on this change in the central bank focusing more on presentation.

Chart 1: BOJ's Measures in Response to COVID-19 (as of 16 Jun)



Source: Extracted from BOJ materials.

In Jul *Outlook Report.* BOJ to emphasize great uncertainty and maintain recovery scenario

In such a situation, the BOJ will hold its MPM on 14-15 July, only a month since its June policy meeting. Because financial markets have stabilized and not enough new data has been collected on the economy after its reopening, little in the way of additional policies is expected. Consistent with the base scenario in the IMF's *World Economic Outlook* published in June, which assumes there will be no second wave of the pandemic, the BOJ is likely to emphasize the great degree of uncertainty while sticking with its scenario of the economy recovering toward the end of 2020 in its July *Outlook for Economic Activity and Prices* report *(Outlook Report).*

BOJ's Jun Tankan showed very clear differences across industries and company sizes

Companies seem to be getting by, thanks to gov't and BOJ policy responses

The BOJ's June Tankan showed very clear differences across industries and company sizes. Looking at the business conditions DI at large companies, automobile-related sectors struggled the most among manufacturers, while personal services and accommodation, eating & drinking services had the worst of it among non-manufacturers. These are the same sectors that the BOJ identified in its April *Financial System Report* as being affected the most (air transportation, lodging, auto sales). In addition, much of the data tells the story of how difficult things are for SMEs—there were further declines in the ratio of recurring profit to sales (down to 1-2%), fixed investment plans were lowered (typically raised in Jun survey as plans solidified), and the financial position DI worsened to its most negative number since September 2013. Still, companies seem to be getting by, thanks to the funding assistance (helped by BOJ lending support), payroll subsidies to support employment, and cash benefits paid out under the government's emergency economic measures.

Japan's exports and production fell to very low levels toward May

Key for recovery from Jun is developments in Asia

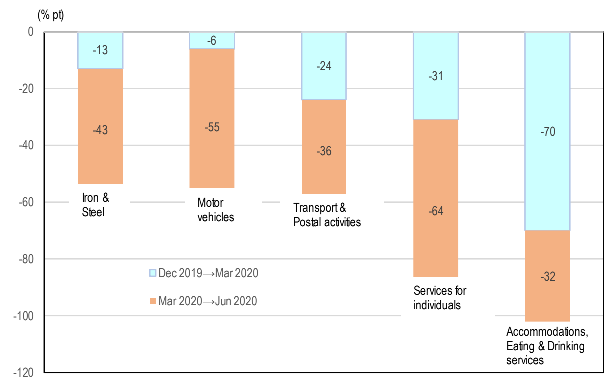
Auto sector accounts for around 20% of Japan's total output and sales

Meanwhile, Japan's exports and production fell to very low levels from March to May (Chart 3). The Survey of Production Forecasts points to a recovery of production from June, driven by transport equipment. Amid weak demand for automobiles in Asian countries (India, Indonesia, Thailand), we do not think conditions are conducive to production being increased as planned. Japan's exports and production are heavily affected by the Asian region. Since early July, India has seen a resurgence of COVID-19 cases. In addition, the heavy rains in the Kyushu region of Japan have forced some automotive-related plants to temporarily shut down. As such, there are multiple unlucky factors. Although we may see a recovery in Jul-Sep, it will not be easy to get back to pre-pandemic levels anytime soon. As the auto sector accounts for around 20% of Japan's total output and sales (or 25% incl. related materials), Japan's economy is unlikely to show strength without improvement in this sector.

Jun data confirmed presence of some pent-up demand

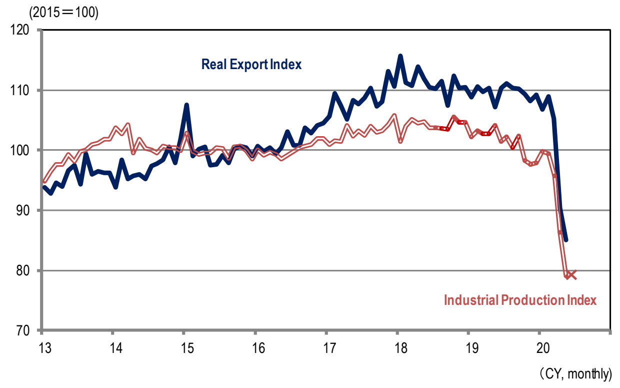
Nevertheless, the latest data for June, which indicates the situation after the nationwide lifting of the state of emergency, was bright, confirming the presence of some pent-up demand. Even in the auto sector, which has been the most glaring example of the demand shock, the June data on new car sales volume showed a recovery from a very low level (Chart 4). However, the level is still quite low relative to that prior to the consumption tax hike last autumn.

Chart 2: Sectors with Large Decline* in Business Conditions DI at Large Companies in BOJ Tankan



Source: BOJ; compiled by Daiwa Securities.
*Cumulative decline of more than 50 from Dec 2019 to Jun 2020.

Chart 3: Real Exports and Production in Japan



Source: BOJ, Ministry of International Trade and Industry; compiled by Daiwa Securities.
Note: X indicates MITI forecast for Jun production (up 0.2% m/m).

Most positive change in consumption in that of goods, but weak rebound in consumption of services

Stay-at-home phenomenon increased spending close to home

Under COVID-19 new normal, key is degree to which services consumption recovers

The current conditions DI in the June *Economy Watchers Survey* showed a V-shaped recovery from its bottom in May (Chart 5). When people move, so do things and money. The most positive change in consumption was in that of goods, but there was not much of a rebound in the consumption of services. This was confirmed by *JCB Consumption NOW*, a domestic consumption activities index based on credit card transaction data. In the first half of June, there was a sharp recovery of spending close to home, including at restaurants, department stores, and apparel stores, but spending on travel, theme parks and other forms of entertainment continued to be weak. The BOJ's May consumption activity index (real, travel balance adjusted) was up 1.3% m/m (down 0.3% in Apr). Despite a recovery, the rebound is weak because of a sharp drop in the services portion, which accounts for over 50% of the index. The Apr-May average was down 12.9% relative to Jan-Mar. Even though goods consumption should rebound in June, real GDP consumption in Apr-Jun is expected to decline by about 8-10% q/q. Under the new normal from Jul-Sep quarter, the consumption trends will be key, particularly the degree to which services consumption recovers.

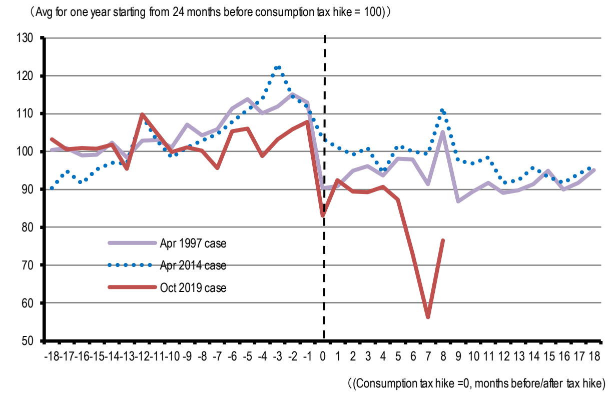
Wise of BOJ to announce forecast range in *Outlook Report*

Despite some positive signs for recent economic indicators, the outlook remains very uncertain. Amid the pandemic, the collection rate is low in statistical surveys (we await final data of *Financial Statements Statistics of Corporations by Industry).* This also makes it difficult to project GDP growth rates as we need to reflect such revisions. We think it was wise of the BOJ to announce a forecast range in its April *Outlook Report* during times like these. As of April, the projection range for FY20 core CPI was from –0.7% to –0.3%, which were already cautious figures. The range for growth rate was from –5.0% to –3.0%, which is likely to be slightly lowered in the July issue.

BOJ would take wait-and-see stance for now, examining effects of policy responses to pandemic

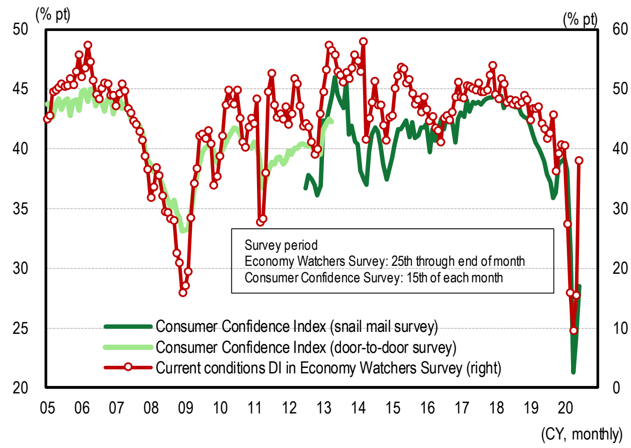
All in all, we expect the BOJ to keep its policy unchanged as its near-term policy focus would be on examining the effects of its "Special Program to Support Financing in Response to the Novel Coronavirus." The central bank will continue to highlight its cooperation with the government, and remain locked and loaded, ready to quickly implement additional measures if needed. It will thus take a wait-and-see stance for the time being. The BOJ would deem that additional easing will be necessary only in the case of major downward revisions to the economic outlook and/or appreciation of the USD/JPY rate staying below Y100, although this depends on the state of COVID-19 infections.

Chart 4: New Passenger Car Unit Sales Around Consumption Tax Hike in Japan



Source: Japan Automobile Dealers Association; compiled by Daiwa Securities.

Chart 5: Household Sentiment Indicators in Japan



Source: Cabinet Office; compiled by Daiwa Securities.

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