

Daiwa's View

Governor Kuroda's press conference suggests that BOJ is in no rush to exit

- Fixed-rate purchase operations on consecutive days are clarified, but will expectations for BOJ's policy revisions bring about a third act?

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BOJ Apr MPM ended with no policy change, as expected

In Apr Outlook Report, growth rate projections were lowered but price forecasts were lifted

Overt clarification of consecutive-day fixed-rate purchase operations as new policy tool

At Governor Kuroda's press conference, many questions asked about latest decision and thinking on weaker yen.

BOJ clarified fixed-rate purchase operations for consecutive days in order to eliminate market speculation

According to policy assessment, easing effect would not be eroded if fluctuations are within a certain range

Fluctuation range over past six months

Governor Kuroda's press conference suggests that BOJ is in no rush to exit

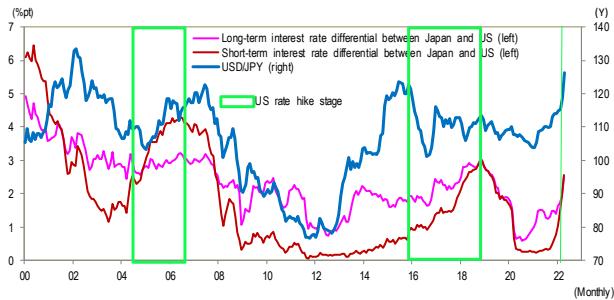
The Monetary Policy Meeting (MPM) held by the BOJ on 27-28 April ended with no policy change, as expected. In its *Outlook for Economic Activity and Prices (Outlook Report)*, the BOJ lowered its growth rate projections for FY21-FY22 but raised its price forecasts for the same period. Rising commodity prices are worsening Japan's terms of trade and the consequent increase in cost-push inflation has a dampening effect on the economy. On 22 April, immediately prior to the blackout period, Governor Haruhiko Kuroda's speech at Columbia University in New York indicated his basic thinking that the BOJ should persistently continue with the current aggressive monetary easing. The contents of the decision at the April MPM were in line with his basic thinking. Nevertheless, one factor worth noting this time is that the BOJ has clarified how it conducts fixed-rate purchase operations for consecutive days, on every business day, as a new policy tool¹. With the BOJ reiterating its commitment to keeping interest rates from rising, such a thorough response was not expected in advance, giving us a surprise. The market grew more comfortable buying 10-year JGBs, and the yield declined to 0.215% on 28 April. Meanwhile, the yen (USD/JPY) temporarily weakened to the Y131 level (Chart 1).

At Governor Kuroda's regular press conference, there were many questions about the clarification of fixed-rate purchase operations for consecutive days and thinking on a weaker yen. When asked about the reason of inclusion of the clarification amid concerns about further depreciation of the yen, he replied that "We thought that clarifying the existing stance at the BOJ would eliminate market instability." He added a comment that "we have clarified it in order to eliminate market speculation on whether the BOJ will conduct operations." Next, when asked about whether conducting fixed-rate purchase operations every business day will inhibit market functions, he explained that "If fluctuations are within a certain range, such operations would have positive impact and easing effects would not be eroded. However, if yields rise beyond the range, this would not have a positive impact on the economy. Therefore, in terms of taking a balance, we showed a fluctuation range of $\pm 0.25\%$, and we followed this range this time." In policy assessment in March 2021², the BOJ analyzed the effects of interest rate fluctuations on business fixed investment. The assessment showed that the degree to which monetary easing affects business fixed investment is more or less unchanged, except when the range of fluctuations in 10-year JGB yields over the preceding six months exceeds 50 basis points (Chart 2). In line with a change in global economic and price conditions, the level of the 10-year JGB yield has shifted upward since the beginning of 2022. The fluctuation range over the past six months is now still $0 \pm 0.25\%$. However, there seems to be potential for an upward shift of the yield level becoming reasonable over time.

¹ Statement on Fixed-Rate Purchase Operations for Consecutive Days (Financial Markets Department: (1) Auction announcement for fixed-rate purchase operations of 10-year JGBs on every business day—The Bank will purchase the bonds with the highest yield between three on-the-run issues at 0.25 percent, and (2) Establishment of a new timetable—The Bank will establish a new timetable of fixed-rate purchase operations in which the offer time is 10:10 and the bid-submission cut-off time is 15:30 (the cut-off time is set at 11:00 on the second day of the Monetary Policy Meeting).

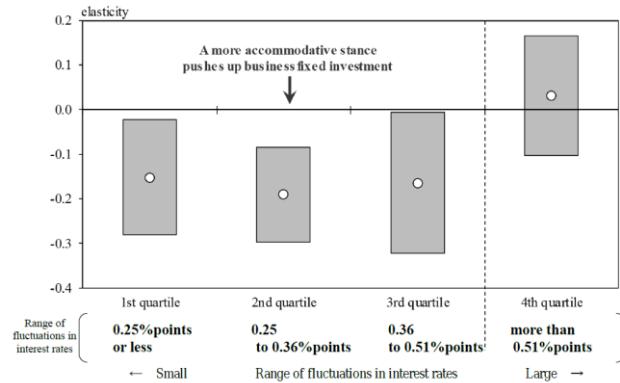
² Refer to PP8-9 and P56 of BOJ's Assessment for Further Effective and Sustainable Monetary Easing: The Background (appendix chart 3, 19 Mar 2021).

Chart 1: USD/JPY, Interest Rate Differentials Between Japan and US



Source: Bloomberg; compiled by Daiwa Securities.

Chart 2: Impact of Interest Rate Fluctuations on Business Fixed Investment



Source: Excerpted from BOJ's Assessment for Further Effective and Sustainable Monetary Easing: The Background (appendix chart 3, 19 Mar 2021).

BOJ does not have a strong sense of crisis regarding current forex level

Impact of excessive fluctuations to be thoroughly watched

BOJ does not assume a continued rise in commodity prices

Negative impact on economy and downward pressure on underlying inflation

As inflation expectations are unlikely to increase fully, BOJ is in no rush to find an exit

Mr. Kuroda worked on expectations when he became Governor in Apr 2013, but he is now like a different person

BOJ should skilfully make use of following wind of increasing expectations for policy revisions

Peter Pan: positive attitude and conviction

Regarding a question whether Mr. Kuroda thinks the merits of yen weakness are large even at this level, he mentioned that “At this moment, my view that depreciation of the yen is positive for the economy overall is unchanged. However, we need to consider aspects where excessive depreciation of the yen has a negative impact.” He remains obstinately opposed to changing his pet idea that the weak yen is positive, but his stance has shifted since 5 April to give consideration to the speed of change. This suggests that the BOJ does not have a strong sense of crisis regarding the current USD/JPY level (Y130 level). However, the central bank intends to “thoroughly watch the impact of forex fluctuations” because “excessive fluctuations increase uncertainties and have an impact on companies’ business plans and the like.”

Next, there were questions and answers about views on prices and judgment of policy operations. When asked about whether the inflation was seen as temporary, Mr. Kuroda pointed out two reasons why inflation of around 2% would not be sustained—“Firstly, we do not assume that prices of commodities, such as crude oil, will continue to rise. Secondly, rising prices of commodities cause income to flow overseas, which has negative impact on the economy and creates downward pressure on underlying inflation.” Looking at price projections in the *Outlook Report*, the BOJ expects core CPI to rise to +1.9% in FY22, but projects it to decline to +1.1% in FY23. Therefore, he stated that “inflation expectations cannot be described as likely to increase sufficiently.” Regarding core-core CPI, which has been newly announced as a reference data this time, he mentioned that “it is expected to rise moderately, but we are not in a situation where we need to rush to find an exit.” As shown in his opinion that “it will take some time before completely returning the economy to a sustainable growth path and stabilizing inflation at 2%,” he is quite cautious about policy revisions. While the government is taking measures to combat inflation, the BOJ is likely to continue to play a role in the provision of easing support for the time being.

When Mr. Kuroda became Governor in April 2013, he eagerly aimed to achieve the 2% price stability target at an early stage by working on expectations. However, he is now like a different person and seems to try to cool down expectations. That said, the increasing speculation/expectations for tapering of BOJ’s easing are evidence of a change in deflation mindset in Japan. I thus think that a golden opportunity to revise different-dimension easing is approaching. The BOJ should skilfully make use of this following wind, but it does not appear to be ready to do that yet. I recall that in his opening remarks on 4 June 2015³, Mr. Kuroda made news by quoting a phrase from the story of Peter Pan—“the moment you doubt whether you can fly, you cease forever to be able to do it”—to emphasize that “what we need is a positive attitude and conviction.” I would now like to remind Governor Kuroda of this phrase. With Japan’s economy recovering to pre-pandemic levels, inflation is finally approaching a long-awaited target of about 2%, whatever form it takes. Under these circumstances, is it really OK to keep the current

³ Refer to P4 of Concluding Remarks of Opening Remarks at the 2015 BOJ-IMES Conference Hosted by the BOJ’s Institute for Monetary and Economic Studies.

policy? I would like to say that Mr. Kuroda should remain confident of being able to fly (re-assessing policy) all the way to the end of his term of office.

Opening act was turmoil in JPY bond market, second act was accelerated depreciation of the yen in forex market

Will expectations for policy revisions by BOJ bring a third act?

Increase in BOJ's ownership share of three on-the-run 10-year JGBs deserves attention

Although the BOJ has clarified how it will conduct fixed-rate purchase operations daily, the market probably still harbors expectations of the BOJ modifying its policy. The opening act in January was a turmoil in the JPY bond market. The second act toward April was accelerated depreciation of the yen in the forex market. Decisions at the April MPM showed that the BOJ's top priority is suppressing a rise in yields and that the bank will not take action to avoid depreciation of the yen. If expectations for policy revisions bring on a third act, market dysfunction may become a concern because repeated fixed-rate purchase operations by the BOJ will raise its share of ownership of the three on-the-run 10-year JGBs (currently at around 40%). In a previous example of this, right before the BOJ expanded its allowable trading band for the long-term yield in July 2018, its share had risen to around 80%. It is possible that an increase in ownership by the BOJ will increase expectations of the trading band being widened (revised). Meanwhile, one key to the next move seems to me to be whether the government and the BOJ make an opportunity to discuss the 2% price stability target after the upper house election in July.

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