

Daiwa's View

BOJ continues persistently with easing, which requires a thorough explanation

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BOJ views upward revision to price projection as temporary

Still expects macro output gap to turn positive around 2H FY22

Governor Kuroda's press conference saw many questions linking price projections with policy

BOJ intends to continue to provide support towards realization of virtuous circle of wages and prices

BOJ continues persistently with easing, which requires a thorough explanation

The BOJ held its Monetary Policy Meeting (MPM) on 20-21 July, which ended without policy revisions as expected. Amid the recent surge in the number of new COVID cases, the BOJ put off making any decisions about extending its "Special Program to Support Financing in Response to the Novel Coronavirus," which is set to expire in September. In the July *Outlook for Economic Activity and Prices* report (*Outlook Report*), the BOJ raised its FY22 price projection to +2.3% from +1.9% as of April. According to the Bank, upside risks are strong for the time being, but it expects inflation to slow down to the 1-2% range from FY23, and the current price gains are temporary, and, therefore, easing needs to be continued. While the economic outlook by the BOJ is bullish compared to that in the private sector, the macro output gap explanation that attracted attention appears to have been toned down. Specifically, the explanation in the April *Outlook Report* read, "(Japan's economy) is projected to turn clearly positive around the second half of fiscal 2022 and then continue to expand moderately," but the word "clearly" was deleted from the same explanation this time. The timing, however, remained the same, being left at "around the second half of fiscal 2022." We are waiting to see if this projection holds true.

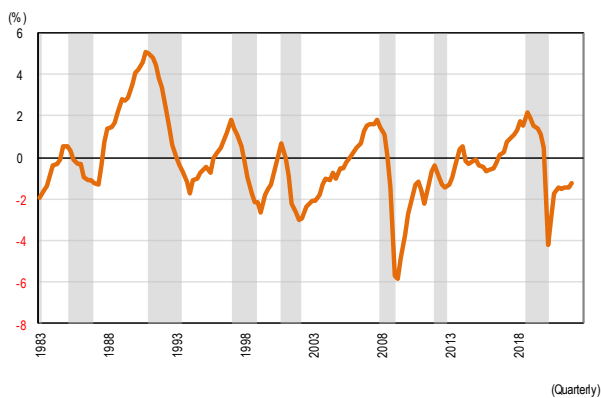
At Governor Haruhiko Kuroda's regularly scheduled press conference, there were many questions that linked price projections with policy. First, he was questioned about the reason why the sustainable price target has not been achieved. He replied that time was needed to shift the way of thinking and practices that had taken root due to the prolonged deflation. Companies' moves to pass higher costs onto customers have become slightly more widespread, and medium/long-term inflation expectations have been rising moderately, in addition to short-term inflation expectations (Chart 2). This time, the BOJ raised core-core CPI projections, but Governor Kuroda mentioned that a further hike in wages was necessary. It can be said that this comment expressed a stance by the BOJ of continuing to provide support until then. Regarding exchange rates, he expressed the sentiment that the current depreciation of the yen was caused by the broad strength of the dollar, saying that he did not think that depreciation of the yen would stop even if interest rates were raised slightly. He emphasized that he was not about to implement rate hikes or change the trading range of the long-term yield, but he said that he was also giving sufficient consideration to functions of the bond market.

Major central banks have entered the rate-hike stage, shining spotlight on BOJ, which is continuing persistently with easing

BOJ needs to provide easy-to-understand explanation to public about why interest rates aren't being raised

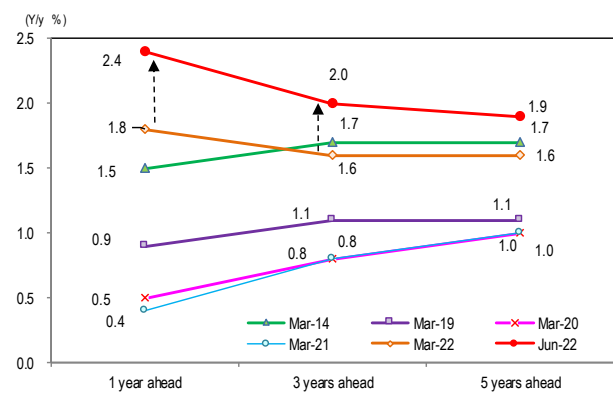
On 21 July, the ECB decided to implement a substantial 50bp rate hike at its Governing Council meeting, exiting from negative interest rates. Major central banks other than the BOJ have entered the rate-hike stage, which shines the spotlight on the BOJ, which is continuing persistently with easing. I think the BOJ needs to provide an easy-to-understand explanation to the public about the reason why only Japan does not need rate hikes. For example, in the process of aiming for the desired level of inflation, the BOJ can indicate points of reference for the wage index level to watch for. As such, it had better find more ways to allow the public to understand the current situation via coordination with the government. With 16 months having passed since the BOJ decided to clarify the trading band of the long-term yield ($\pm 0.25\%$) at its policy assessment meeting in March 2021, the global economic/price conditions have changed drastically. The BOJ also needs to provide a thorough explanation to the market regarding the appropriateness of this yield level.

Chart 1: Trend of Output Gap Estimated by BOJ



Source: BOJ; compiled by Daiwa Securities.
 Note: Shaded areas indicate recessions.

Chart 2: Inflation Outlook of Enterprises in BOJ Tankan (all-size enterprises/all industries)



Source: BOJ; compiled by Daiwa Securities.

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