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Daiwa's View

Signaling assessment/review with new BOJ Governor

- Start of assessment/review is almost in line with expectations, but two points are different from the past
- Yield upside potential at the time of policy revisions is diminishing due to lower yields in Europe and US

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Signaling assessment/review with new BOJ Governor

◆ Signaling assessment/review with new BOJ Governor

Start of assessment/review is almost in line with expectations, but two points are different from the past

Yesterday, there were reports in the news that, according to people familiar with the matter, Bank of Japan officials thought it was possible that there could be a policy review next year, after wage growth and any slowdown in the global economy were closely examined. This signals that an assessment/review might be conducted with the new governor, but not with Governor Haruhiko Kuroda.

Since the Comprehensive Assessment in July 2016, the BOJ has been conducting policy assessments about once every two or three years (such as in Jul 2018 and Mar 2021, with the next perhaps in Apr 2023). There are no strict rules regarding this, but, given the timing of past assessments, we don't see a problem with it being scheduled for April 2023 or later. That said, the signaling this time around by way of the media based on information from people familiar with the matter differs from the past in at least two respects. Firstly, the meeting for starting the next assessment/review is still a long way off (at least four months in the future). In past cases, the intended changes were to be made at a meeting relatively soon after the signal was sent. Secondly, the takeaway at this point is that they are starting from scratch—the media said that there is no consensus within the BOJ at this point regarding the pros and cons or the details of the assessment/review. With the past two assessments, the fact that there would be a change (expansion/clarification) in the trading band in the yield curve control (YCC) policy was essentially signaled in advance.

While it is true that this is happening during a change of governor, we feel this signal indicates that the BOJ has resolved not to draw premature conclusions, and intends to (1) discern trends in overseas economies whose downside risk is increasing and (2) make sure whether there is a clear change in trends with wage hikes. Some, including our chief market economist Mari Iwashita and chief economist Toru Suehiro, have already expressed their views regarding policy revisions. (Both Iwashita and Suehiro anticipated an assessment/review.) There is a good chance that an assessment or review will be implemented. But, of course, another outcome is also possible.

The implications of BOJ encouraging submissions of counterproposals?

With regard to the fact that an assessment/review that is still a little ways off is being hinted at, the BOJ appears to be aiming to implement its next policy as an 'agreed process,' after the media, economists, and market participants have had a sufficient exchange of views. In other words (if critics of the BOJ policy are asserting that there actually are good counterproposals), the BOJ is encouraging people to present better proposals than the current one. In that case, rather than simply hear critical or pessimistic views about the current situation or proposals for fine-tuning that assume the current situation, we would like to see counterproposals that (1) provide a quantitative comparison of the merits and demerits of the proposed policy and (2) can be examined objectively based on data available to third parties.

◆ Yield upside potential at the time of policy revisions is diminishing due to lower yields in Europe and US

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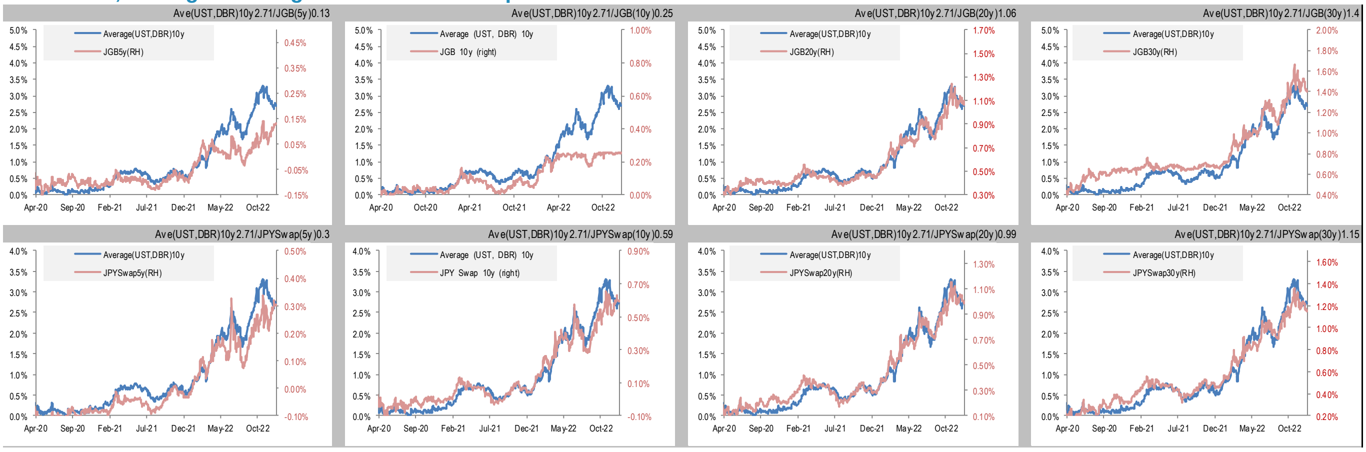
Upward potential for yields at the time of policy revisions appears to be diminishing in line with the substantial drop in overseas yields. For example, the following charts showing trends in JGB yields (pink) and the average for long-term yields in the US and Germany (blue) show that downward pressure on superlong JGB yields, which had moved mostly in line with long-term yields in Europe and the US, is strengthening due to peaking of long-term yields in Europe and the US. It is highly possible that this overseas yield trend is one factor behind the recent drop in superlong JGB yields and flattening of the yield curve.

JGB Yields, Average for Long-term Yields in Europe and US



Source: Bloomberg; compiled by Daiwa Securities.

Regarding the zone up to 10-year residual maturities, short-term/intermediate yields have continued to rise against the drop in global yields since the remarks by BOJ board member Naoki Tamura[1]. As a result, the rise mainly in JPY swap rates is suspected to be somewhat excessive compared to overseas rates. If the BOJ increases control of the front end of the curve via modifications to forward guidance when it revises the fluctuation range of the long-term yield, which our chief market economist Iwashita pointed out could happen, the 5-year JGB yield may rise little even if there are policy revisions. (The 10-year JGB yield is expected to rise, but the upside is lessening due to lower overseas yields.)

In the first half of 2023, we anticipate a substantial slowdown (or recession) in the US economy and suspension of rate hikes by the Fed. The US long-term yield may decline further from the current 3.48%. Paradoxically, if such a situation were to occur, the BOJ could implement policy revisions without causing a sharp rise in market interest rates. (Of course, the point of rate hikes during a sharp slowdown in the global economy would be questioned.) The timing for the assessment/review will likely be decided not only based on Japanese factors like the change in BOJ Governor, but also after carefully monitoring trends such as downside risk with overseas economies and suspension of rate hikes by the Fed.

[1] BOJ board member Naoki Tamura's first interviews with the media since taking office in July were carried late in the night of 2 December (Bloomberg) and in the morning edition of the *Asahi Shimbun*. In both cases, he shared his view that, "It would be appropriate to conduct a review at the right time, including the monetary policy framework and 2% inflation target." He also said, "As long as the economy is achieving a virtuous cycle, I think it's okay even if inflation is at, say 1.8%." He added that the Bank's way of thinking should be more flexible and less rigid.

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