Daiwa Securities

Daiwa's View

BOJ surprise underscores problem in terms of communication with market

- BOJ unexpectedly decided to expand trading band for long-term rates at Dec meeting

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BOJ unexpectedly decided to expand trading band for long-term rates at Dec meeting

Hard to forecast flexible responses in each maturity

Minor change in policy demonstrates difficulty of revising policy framework

Following its last monetary policy board meeting of the year on 19-20 December, the BOJ surprised the market with a unanimous decision to widen the trading band for long-term rates from the target level (from around ±0.25% to around ±0.50%). I had expected the BOJ's next move to be raising the long-term rate trading band out of concern for declining market functionality, but that it did so so soon was a surprise. The BOJ stated that the modifications this time were aimed at encouraging a smoother formation of the entire yield curve via the combination of an increase in the JGB purchase amount and flexible responses in each maturity, alongside the expansion of the trading band. However, it is unclear how these modifications will have an impact on maturity zones other than 10 years. It has become difficult for us to forecast daily movements. It is a good thing that the BOJ opted to not make this move near the end of the fiscal year, but problems will remain in terms of communication with the market in the future. While the BOJ was able to make this minor change in policy, we must realize that it will be much more difficult for the BOJ to craft a strategy to modify the policy framework and exit from its YCC policy, including abandoning negative interest rates. Overseas investors may interpret this as an initial first step and react differently. In my opinion, a YCC exit strategy would require coordination between the BOJ and MOF, the entity in charge of managing the government's debt. Either way, it will be important to keep a close eye on future trends in prices, wages, and the economy.

Widening of trading band aims to increase sustainability of easing policy, and is not a rate hike

No convincing explanations provided to questions in market; market may once again be driven by pressure on BOJ for more action

At his regularly scheduled press conference, Governor Haruhiko Kuroda said that the latest response was aimed at increasing sustainability of easing policy, and that it was not a rate hike. He once more emphasized that it was too early to discuss an exit strategy, as it took time before seeing a sustainable rise in wages and prices. Meanwhile, he mentioned that, with real yields declining due to a rise in inflation expectations, this was having a greater effect in terms of stimulating the economy, and expressed the view that widening of the trading band would have no negative impacts. Moreover, he stated that he did not think that the joint statement needed to be revised at this point. Governor Kuroda did not appear to provide convincing explanations to the market regarding questions such as why the decision was made at this meeting, whether there was a possibility of further expansions of the trading band, and whether market functionality would actually improve. While the market is waiting for the next BOJ Governor to take office, it may once again be driven by pressure on the BOJ for more action due to its latest decision.

Modification of the Conduct of Yield Curve Control (YCC) on 20 Dec 2022

Impact of Increased Volatility in Overseas Markets

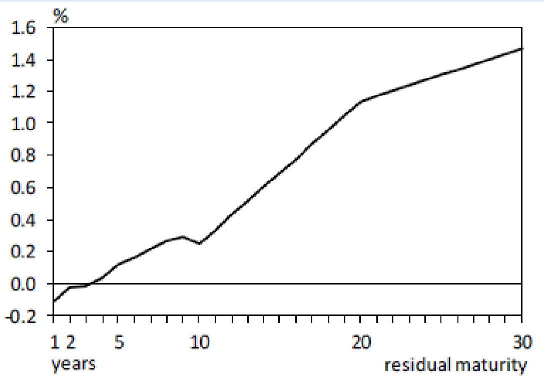
Deterioration in Japan's bond market functioning

- Relative relationships among interest rates of bonds with different maturities
- Arbitrage relationships between spot and futures markets

Possibility of a negative impact on financial conditions

Yields on Japanese government bonds (JGBs) are reference rates for corporate bond yields, bank lending rates, and other funding rates.

JGB Yield Curve (Before the December 2022 MPM)



Source: Bloomberg

Measures Decided by the Bank of Japan

Conduct of YCC

Encourage a smoother formation of the entire yield curve

Significant increase in the amount of JGB purchases: from 7.3 trillion yen per month to about 9 trillion yen per month

Expansion of the range of 10-year JGB yield fluctuations from the target level: from between around ±0.25% pts to between around ±0.5% pts

Nimble responses for each maturity:

- Offer to purchase 10-year JGBs at 0.5% every business day through fixed-rate purchase operations
- Make nimble responses for each maturity by increasing the amount of JGB purchases even more and conducting fixed-rate purchase operations

In adjusting the amount outstanding of corporate bonds, the Bank will give due consideration to their issuance conditions.

Facilitate the transmission of monetary easing effects generated under the framework of YCC, such as through corporate financing

The Bank will aim to achieve the price stability target by **enhancing the sustainability of monetary easing**.

Source: Reprinted from BOJ materials.

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