Daiwa Securities

Daiwa's View

Points warranting attention toward Golden Week

➢ (1) Timing for SLOOS and FOMC releases, (2) speculation about BOJ forward guidance revisions

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The likelihood of the FOMC raising interest rates at its May meeting has increased to more than 80% following hawkish comments from Federal Reserve Governor Chris Waller late last week. As a result, the 10-year US Treasury yield topped 3.5% for the first time in a while. Regarding the recent sluggishness for (headline) CPI/PPI data, Waller said that US central bankers "haven't made much progress" returning inflation to their 2% target. He dismissed the optimistic view of inflation that has pervaded the market and stressed the need for additional monetary tightening.

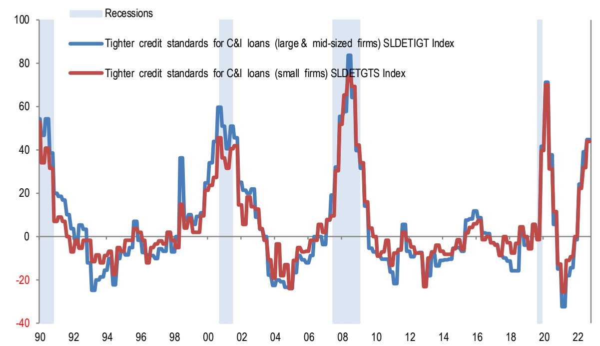
That said, even hawkish Fed Governor Waller confirmed that he is prepared to flexibly adjust his stance depending on the tightening of credit conditions that appears to have emerged since the collapse of Silicon Valley Bank in early March. On this point Waller said, "My workload has been somewhat reduced as credit conditions have begun to tighten." He also said, "We may not need to raise rates as much as I thought we would in February. There are still a little over two weeks until the next FOMC meeting, and I am ready to adjust my stance based on what I learn about the economy, including lending conditions." The most important data on credit conditions to be submitted to FOMC members within the next two weeks will be the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS). The above remarks also indicate that the next SLOOS, which will be compiled after some time has passed since the collapse of Silicon Valley Bank, will be an important document for discussions at the May FOMC meeting.

One point to keep in mind from a market perspective is that the SLOOS will not be released to the public until after the May FOMC meeting. This means that investors will have to infer the contents of the SLOOS from the May FOMC decisions. If, contrary to market consensus, a rate hike at the May meeting is skipped, we could easily anticipate speculation that SLOOS indicated tighter credit conditions than the Fed had expected. This is one point that should be kept in mind as a potential market catalyst during the Golden Week holiday.

10Y US Yield, Inflation Expectations

Source: Bloomberg; compiled by Daiwa Securities.

Senior Loan Officer Opinion Survey



Source: Bloomberg, compiled by Daiwa Securities.

◆ Speculation about forward guidance revisions

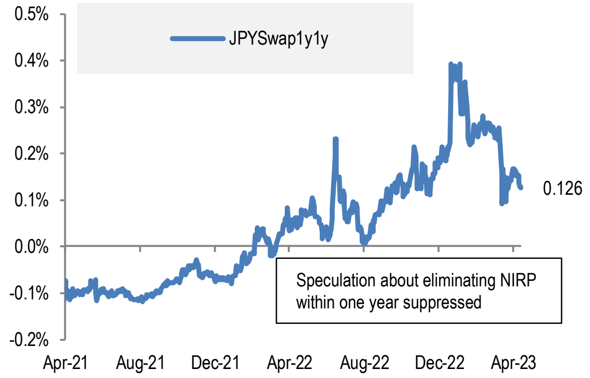
Late last week, Ranil Salgado, the IMF's Japan mission chief, said during an interview in Washington that Japan's inflation outlook faces both upside and downside price risks for Japan, noting that, "In our view, bias should be neutral." Needless to say, these comments suggest that the BOJ needs to change its forward guidance for short- and long-term policy interest rates, currently defined by the Bank as "remain at their present or lower levels." Meanwhile, on 8 May the government plans to reclassify the "novel coronavirus" under the Infectious Diseases Control Law from the current "Class 2" to "Class 5" (equivalent to seasonal influenza). This too could easily lead to speculation about revising the BOJ's current forward guidance, which is tied to the state of the coronavirus outbreak. As such, this is a theme likely to receive increased attention in the future.

BOJ Monetary Policy Meeting (10 Mar 2023)
For the time being, while closely monitoring the impact of COVID-19, the Bank will support financing, mainly of firms, and maintain stability in financial markets, and will not hesitate to take additional easing measures if necessary; it also expects short- and long-term policy interest rates to remain at their present or lower levels.

However, during his inaugural press conference, new BOJ Governor Kazuo Ueda touched on the negative interest rate policy (NIRP), for which the outlook is defined by the Bank's forward guidance. Specifically, he said that (1) continuing under the assessment that the current underlying inflation rate has not yet reached 2% is appropriate and (2) the financial intermediary function is performing well with efforts being made to minimize negative impacts on earnings (brought about by BOJ policy). In this manner he successfully communicated to the market both the Bank's willingness to continue easing and the high hurdles it faces in terms of ending NIRP. In fact, the derivatives market also indicates that moves to factor in the elimination of negative interest rates by the end of this year have been toned down significantly following Ueda's inaugural press conference (see left-side chart below).

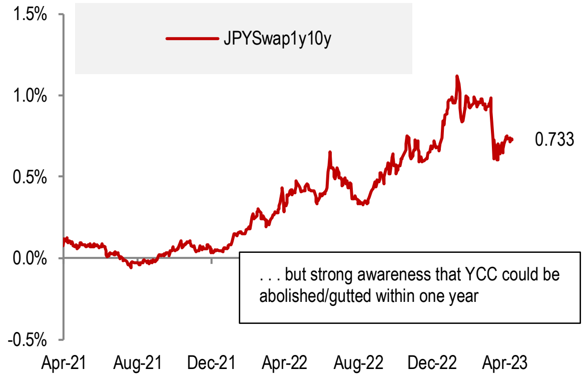
Market participants are now convinced that the BOJ will not eliminate NIRP in the near future. However, from a somewhat different angle, the current situation can be seen as fulfilling one of the necessary conditions for smoothly revising the easing bias within the current forward guidance, which is tied to the state of the coronavirus outbreak. Eyes are on whether Governor Ueda can make corrections, while keeping the forward guidance revisions and exit (rate hike) strategies separate, and without any market turbulence. Even though good progress has been made so far, if there are any moves to revise forward guidance, speculation about an exit strategy could increase, which could lead to market turmoil, including efforts by speculators to again force the BOJ to change its YCC policy. In that case, difficulty communicating with the market during the easing correction phase could become a new concern.

1Y-forward 1Y JPY Swap Rate



Source: Bloomberg; compiled by Daiwa Securities.

1Y-forward 10Y JPY Swap Rate



Source: Bloomberg, compiled by Daiwa Securities.

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