Daiwa's View

How will BOJ address price forecasts, fate of YCC?

➢ Expect ingenuity, communication changes from BOJ

Fixed Income Research Section
FICC Research Dept.

Chief Market Economist
Mari Iwashita
(81) 3 5555-8852
mari.iwashita@daiwa.co.jp

Daiwa Securities Co. Ltd.

How will BOJ address price forecasts, fate of YCC?

Government's high-price countermeasures reflected in Oct Outlook Report price forecasts

FY24 price forecast in 2% range, topping 2% price stability target for third straight year

On 31 October, the BOJ will announce the results of its Monetary Policy Board meeting and release its *Outlook for Economic Activity and Prices* (*Outlook Report*). According to the front page of the 28 October *Nikkei* morning edition, the BOJ's forecasts will partially reflect the impact of the government's economic stimulus measures[1]. While troubled by the sensitive timing (economic measures to be approved by the Cabinet on 2 Nov), this factor was not reflected in the author's forecasts. If pressed to update our forecasts reflecting the latest information, we would do so along with the BOJ revises its forecasts (Chart 1). Various conventional media reports had explained that core CPI is expected to increase to nearly 3% in FY23. However, the extension of measures to address high prices will pull core CPI slightly back from the 3% level. Meanwhile, it was expressed that a 2% level for FY24 has come into view, but that is probably now seen as a certainty with the rebound in FY23. As a result, the 2% price stability target will be exceeded for the third straight year, moving closer to realizing sustainability and stability at that level.

If BOJ raises price outlook, it must explain how conditions changed

BOJ remains cautious on lack of confidence in wage growth sustainability

The BOJ has used the expression "Nimbly respond to developments in economic activity and prices, as well as financial conditions" in its meeting statements since April. If the price forecasting accuracy is improved this time and the price outlook for FY23-24 is raised, the BOJ will need to make some kind of response or explain how conditions have changed. For example, its wording could be changed from "still a long way to go" to "closer than before" or "realization is in sight" for the conventional goals to indicate that recognition has moved forward. However, the BOJ, not wanting to make a mistake in its policy decisions, seems to remain cautious due to (1) lack of sufficient data in the form of "accompanied by wage increases," as mentioned in its statements and (2) the projected figure for FY25 is far from 2% and there is no confidence in the sustainability of wage increases. That said, with the price forecast exceeding 2% through FY24, these explanations are probably difficult to understand, especially among foreign investors.

Chart 1: Forecasts for BOJ Policy Board Members' Projections (median, y/y %)

	Real GDP			Core CPI			Core core CPI		
	Jul 2023*	**Oct 2023****	My forecast	Jul 2023*	**Oct 2023****	My forecast	Jul 2023*	**Oct 2023****	My forecast
FY23	+1.3 %	**+1.8 %**	+1.8 %	+2.5 %	**+2.7 %**	+2.7 %	+3.2 %	**+3.5 %**	+3.4 %
FY24	+1.2 %	**+1.0 %**	+0.9 %	+1.9 %	**+2.2 %**	+2.2 %	+1.7 %	**+1.9 %**	+1.8 %
FY25	+1.0 %	**+1.0 %**	+1.0 %	+1.6 %	**+1.6 %**	+1.8 %	+1.8 %	**+1.8 %**	+1.8 %

Source: BOJ, various materials; compiled by Daiwa Securities.
Note: In yellow highlighted columns, FY23 figures have been revised downward and FY24 figures have been revised upward from figures as of 19 Oct.
**BOJ projections.*
***My estimates for policy board member projections.*

[1] The *Nikkei* report noted that with the government extending subsidies for electricity, gas, and gasoline until the spring of 2024, the momentum for price increases in FY23 will weaken to a certain extent, while the rate of increase in FY24 is likely to be higher than during the previous year as the subsidies are removed.

10yr JGB yield rise factors, higher-than-expected prices in Japan, inflation expectations stuck at high level

Since the start of October, the 10-year JGB yield has traded above 0.80%. On 26 October, the yield briefly reached 0.885%, the highest level since July 2013, ten years and three months ago. The previous day's rise in the 10-year UST yield was explained as the reason for the increase. Still, we believe that the main trend and factor behind the 10-year JGB yield is the continued upward movement of prices and inflation expectations stuck at high levels in Japan since the release of the last *Outlook Report* in July. The abovementioned advance media reports about a potential price outlook hike in the October *Outlook Report* also strongly reminded the market of the upward swing in prices.

Overall price outlook for firms in Tankan over 2% for sixth straight quarter

Prices still perceived as high in Opinion Survey

The September Tankan report was released on 2 October. In the general inflation outlook for all enterprises / all sizes, the medium/long-term inflation rate outlook three years ahead was 2.2% y/y, down slightly from the 2.3% reading in the March report, but holding above 2% for the sixth straight quarter. Meanwhile, the BOJ's Opinion Survey on the General Public's Views and Behavior (Opinion Survey) was released on 13. As for the price perceptions, when asked to give a specific percentage change in prices one year from now compared to the current level, respondents gave the following responses: average of +10.7% (+10.0% in previous survey) and median of +10.0% (+10.0%) (Chart 2). Likewise, when asked to give a specific percentage change in prices over a five-year span compared to the current level, respondents gave the following responses: average of +8.0% (+7.5% in previous survey) and median of +5.0% (+5.0%) (Chart 2). The averages increased, while the median held steady at high levels, so we can recognize household inflation expectations as quite high.

Gradual upward trend for underlying inflation rate

Oct Tokyo core CPI +2.7% y/y, above market expectations

Higher service prices contributed pushed up inflation

Meanwhile, the underlying inflation rate is in a gradual upward trend. Among the indicators[2] used to capture the underlying inflation rate released by the BOJ on 24 October, the September trimmed mean was +3.4% y/y (+3.3% in Aug), the weighted median was +2.0% (+1.8%), and the mode was +2.8% (+3.0%). Only growth for the mode slowed, but all three readings were in the 2% and higher range (Chart 3). The Ministry of Internal Affairs and Communications released October CPI data on 27 October. Tokyo core CPI was up 2.7% y/y (up 2.5% for Sep), accelerating m/m and topping the up 2.5% market forecast. Core CPI excluding energy (core-core CPI) was up 3.8% (up 3.9% in Sep). The reading slowed somewhat, but remained above 2% for the 13th straight month, remaining at a high level, albeit just below 4%. In October, the reduction of electricity and gas price control measures[3] and a pause in food price hikes (fewer items increased in price compared to October 2022) pushed down prices, whereas a sharp increase in lodging rates[4] and service price hikes, including higher Internet access fees, contributed to a boost in prices. As was the case at the start of the new fiscal year in April, service price increases were widespread in October, the beginning of fiscal year's second half. In addition, the rise in goods prices, starting with import prices, was thought to be over, but there could be a resurgence due to the recent rise in crude oil prices and the yen's persistent depreciation.

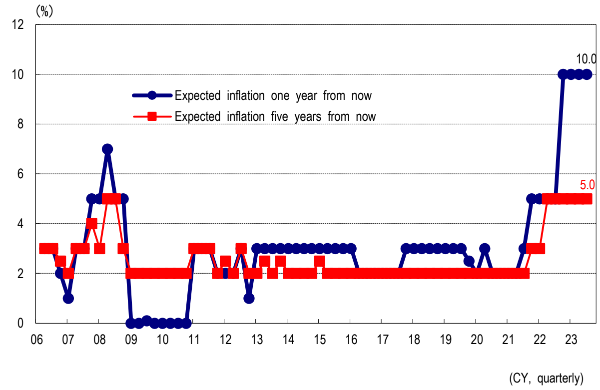
---

[2] The trimmed average is the value obtained by automatically deducting a fixed percentage (10% each up and down) of the two ends of the distribution of price changes by item. The weighted median value is the value that is near 50% after accumulating the weights in order of highest to lowest price rise. The mode is the most frequent rate of price change in the distribution of price changes by item.

[3] According to the Ministry of Internal Affairs and Communications, the impact (contribution) of the government's high price countermeasures in Tokyo for October is estimated to be -0.31%pt (-0.62%pt in Sep) for electricity and -0.14%pt (-0.29%pt) for city gas for a total of -0.45%pt (-0.91%pt). The pushing down effect of the control measures was reduced by half compared to September.

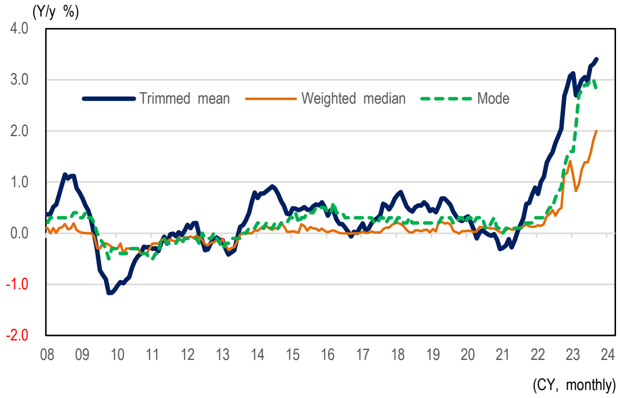
[4] The drop-off of factors from the start of nationwide travel support last October, coupled with a recovery in demand from foreign tourists visiting Japan, led to a significant 42.8% y/y increase in Tokyo lodging rates.

Chart 2: Perception of Price Levels (median) **in Opinion Survey on the General Public's Views and Behavior**



Source: BOJ; compiled by Daiwa Securities.

Chart 3: Underlying Fluctuations of Japan's CPI



Source: BOJ; compiled by Daiwa Securities.

Expect sustained wage growth toward spring 2024 labor negotiations

The Japanese Trade Union Confederation, or *Rengo*, on 19 October confirmed its draft plan to demand an average wage hike of "at least 5%" in 2024, ahead of the annual spring labor-management wage negotiations (stronger wording than the "around 5%" used this year). Some companies are declaring wage hikes at their provisional job offer ceremonies in October. Also, a 20 October *Nikkei* interview reported that Suntory Holdings has decided to raise wages by about 7% in 2024 (same as in 2023), including base pay. This trend is expected to continue with higher wage settings next year, which is expected to have the potential to sustain wage growth. Toward the end of the year will be the time to see how many companies declare sustained wage increases.

Many within BOJ cautious about reaching 2% price target

Only board member Noguchi has spoken since Sep meeting

Hope BOJ provides path toward normalization

The BOJ is placing more emphasis on core-core forecasts as the underlying prices (Chart 1) and if the figures for FY24 and beyond are close to 2%, the realization of the 2% price stability target will be closer. However, given the high level of uncertainty about the future, many within the BOJ are still holding cautious views. Only Monetary Policy Board member Asahi Noguchi has given a speech since the September meeting (12 October), and we feel that the BOJ is failing to disseminate enough information. Deputy BOJ Governor Ryozo Himino has yet to make his speaking debut since taking office on 20 March. According to the Summary of Opinions for the September meeting, there were three forward-looking opinions regarding policy normalization. Grasping the opinions of all members and identifying the views of individual members is not possible, except for Naoki Tamura, who is a clear hawk. We would like the BOJ to devise a way to disseminate information in this regard without bias by its members. If the current approach continues, the market will become skeptical and stuck until the BOJ makes its next move. In order to prevent a deterioration of market functions, it is desirable for a central bank, as the guardian of prices, to present a path toward normalization, even if just to a small degree.

Various reports suggest Oct meeting will not produce serious policy changes

Significant downside risks to economy, forward guidance difficult to revise

According to media reports over the past week, at its October meeting the BOJ will maintain its current monetary easing, specifically the application of a -0.1% short-term rate and an "around 0%" 10-year JGB yield target (25 Oct; *Yomiuri Shimbun* morning edition). The YCC framework will likely be maintained no earnest policy changes. With the addition of new uncertainties surrounding the situation in Israel, the downside risks to the economy remain significant. At this time, revising the forward guidance (removing the "if necessary" part) is difficult. As the 10-year JGB yield rises and approaches the 1% mark, which was far away as of July, "the pros and cons of policy revisions, including a precautionary response, will be discussed" (Bloomberg, evening of 24 Oct). A Reuters report on the evening of 25 October said the BOJ will ascertain market trends until just before the meeting and then carefully determine the necessity of policy revisions.

Further YCC revisions to be determined based on long-term interest rate trends

Easing of yen depreciation pressures in case of deciding to take action before "YCC attack (targeting 1% level)

50-50 chance BOJ will take some action

The BOJ could decide to take limited measures before a YCC attack (= short selling of JGBs by speculators trying to force a BOJ policy change by forcing the 10-year JGB yield up toward 1%). This could be to ease yen depreciation pressure, as was the case in December 2022 and July 2023. Specific further YCC revision proposals could include (1) further elevation of upper bound for 10-year JGB yield permissible trading range (currently 1%), (2) change in the way fixed-rate purchase operations for consecutive days are conducted, and (3) removal of the watered down "around 0.5%" target for the 10-year JGB yield permissible fluctuation range. If no action is taken at the October meeting, the Bank will have to be prepared to continue to conduct a series of operations for 50 days until the next meeting on 18-19 December in order to defend the 1% rate. Depending on developments in the US, uncertainty as to how far the yen could weaken would persist. Still, we see a 50-50 chance that the BOJ will either (1) choose to wait / be allowed to wait by the government or (2) move forward. In any case, at the October meeting we look forward to some changes regarding the Bank's ingenuity and messaging.

Is BOJ's role to prevent yen depreciation to support government's high prices countermeasures?

Jan 2024 meeting critical time for price decisions

Over the next six months or so, it would seem the right role for the BOJ is to modify its excessive monetary easing and prevent the yen from weakening in a way that supports with the government's measures to counter high prices. We believe that a virtuous cycle of higher prices and higher wages is starting to emerge in those companies that are performing well. It will take time for a broader spreading of this cycle. If it waits too long, the BOJ will fall behind the curve. The Bank should be able to determine outlooks based on corporate earnings, the passing on of higher costs to prices, and price trends. We remain of the opinion that the January meeting next year, when data will be available (following the 4 Dec meeting including the "Review of Monetary Policy from a Broad Perspective"), will be an important time for price decisions.

Ratings
Issues are rated 1, 2, 3, 4, or 5 as follows:
1: Outperform TOPIX/benchmark index by more than 15% over the next 12 months.
2: Outperform TOPIX/benchmark index by 5-15% over the next 12 months.
3: Out/underperform TOPIX/benchmark index by less than 5% over the next 12 months.
4: Underperform TOPIX/benchmark index by 5-15% over the next 12 months.
5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

Target Prices
Daiwa Securities Co. Ltd. sets target prices based on its analysts' earnings estimates for subject companies. Risks to target prices include, but are not limited to, unexpected significant changes in subject companies' earnings trends and the macroeconomic environment.

Disclosures related to Daiwa Securities
Please refer to https://lzone.daiwa.co.jp/l-zone/disclaimer/e_disclaimer.pdf for information on conflicts of interest for Daiwa Securities, securities held by Daiwa Securities, companies for which Daiwa Securities or foreign affiliates of Daiwa Securities Group have acted as a lead underwriter, and other disclosures concerning individual companies. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Explanatory Document of Unregistered Credit Ratings
This report may use credit ratings assigned by rating agencies that are not registered with Japan's Financial Services Agency pursuant to Article 66, Paragraph 27 of the Financial Instruments and Exchange Act. Please review the relevant disclaimer regarding credit ratings issued by such agencies at: https://lzone.daiwa.co.jp/l-zone/disclaimer/creditratings.pdf. If you need more information on this matter, please contact the Research Production Department of Daiwa Securities.

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association, Japan Security Token Offering Association