

Daiwa's View

BOJ Deputy Governor Uchida's speech confirms BOJ is pricing in moderate rate hikes

- Speech is strong indication of stance of maintaining interest rates at low levels, in terms of both short term and long term
- Goldilocks market environment expected

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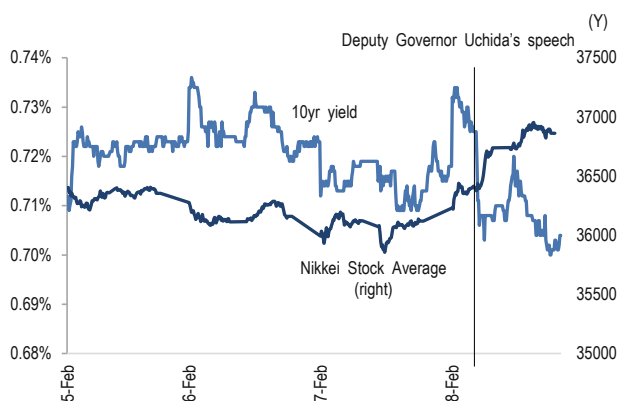
Following the release of BOJ Deputy Governor Shinichi Uchida's speech on the morning of 8 February, the 10-year JGB yield declined, after having risen at the opening of trading. On that day, the Nikkei Stock Average jumped (rising 2.1% d/d) in line with lower yields. As such, Goldilocks reactions occurred (left-hand chart).

We can point out two topics in this speech that will have an impact on yields: (1) the path of short-term interest rate hikes and (2) the policy of controlling the long-term interest rate.

The important point in this speech is that the BOJ has confirmed that it is taking the accommodative rate hike path that has been priced in by the bond market.

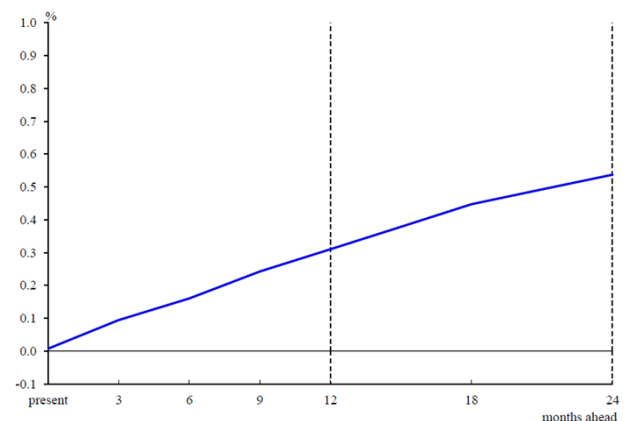
First, regarding (1) the rate hike path, he explained that "The Bank's basic thinking is to examine the current situation of and outlook for economic activity and prices, and then set the policy interest rate at an appropriate level so that CPI inflation will be at around the 2 percent target." He then stated that, based on current economic and price outlooks, "even if the Bank were to terminate the negative interest rate policy, it is hard to imagine a path in which it would then keep raising the interest rate rapidly. The Bank would, I think, maintain accommodative financial conditions even if the termination were to take place."

Daytime Price Movements



Source: Bloomberg; compiled by Daiwa.

Market Expectations for Policy Interest Rate (forward OIS)



Source: Reprinted from BOJ materials.

Making reference to the pricing in of rate hikes by the OIS market, he stated: “the market currently is assuming a very gradual path for the policy interest rate. The Bank refers to such views incorporated in financial markets when making assumptions on the policy interest rate ... Nonetheless, the Bank does not project that inflation will significantly exceed 2 percent” (right-hand chart on page 1).

The market is factoring in a moderate rate hike path to around 0.5% in two years. The fact that, even based on this, the BOJ’s inflation projections do not greatly exceed 2% means that pricing in additional tightening is not necessary. In other words, we can understand that the BOJ has confirmed the accommodative rate hike path that has already been priced in by the bond market.

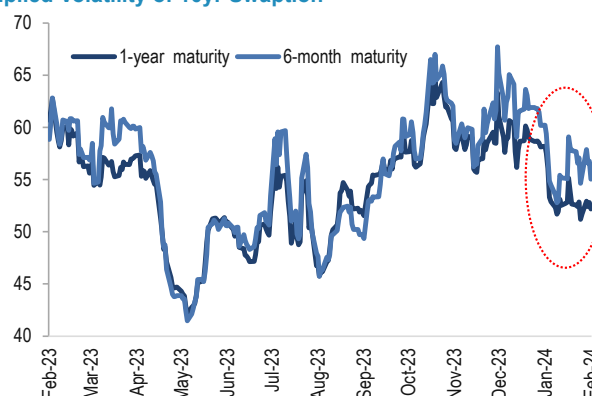
Then, with regard to (2) the policy of controlling the long-term interest rate, he stated that “the conduct of yield curve control and subsequent JGB purchases are part of a continuing process.” He also stated: “If the Bank does revise the framework, it will incline more toward letting interest rates be determined by the market. In doing so, however, it will take careful measures so as not to create discontinuity before and after the revision, and will make sure that the amount of JGB purchases will not change significantly and interest rates will not rise rapidly.”

In this regard, the policy of responding to avoid a rapid rise in interest rates indicates a stance of attempting to rein in a rise in yields caused by rate hikes from the standpoint of the long-term interest rate.

As a whole, the speech strongly indicates a stance of maintaining interest rates at low levels in terms of both the long term and the short term. The idea of waiting for inflation expectations to become anchored at 2% through achieving a high-pressure economy by maintaining low interest rates amid a gradual rise in recent inflation expectations envisions a Goldilocks market environment.

If the BOJ were to succeed in controlling the market, that would reduce uncertainty regarding the outlook going forward, which would lower volatility and improve the risk/reward situation with securities investments. After the release of the speech, the implied volatility of the 10-year JPY swaption declined, and stock prices jumped amid a slight decline in yields. These movements allow us to forecast such a market trend.

Implied Volatility of 10yr Swaption



Source: Bloomberg; compiled by Daiwa.

◆ BOJ Deputy Governor Shinichi Uchida (8 Feb 2024)

"A state with positive interest rates" will not be achieved merely through the Bank raising interest rates. It will only be possible if economic activity and prices improve, thereby realizing the situation where raising interest rates is appropriate.

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