

Keys to the BOJ MPM (26-27 Apr)

BOJ Watch Commentary REPE821

The first policy meeting in BOJ Governor Kuroda's second term

- The BOJ is likely to maintain in its policy statement its assessment of the economy and the target increase in the amount of JGB holdings.
- We want to see what BOJ Governor Kuroda says during his press conference about ETF purchases and the side effects of prolonged easing.

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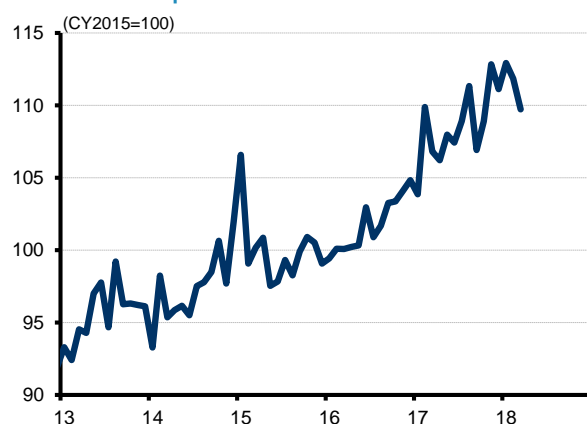
BOJ likely to stay on hold at first policy meeting under new team of top officials

The BOJ's first policy meeting with its two new deputy governors is coming up. The BOJ's March *TANKAN* survey and its latest *Regional Economic Report* (the *Sakura Report*), released earlier this month, show further improvement in economic growth but slightly more cautious views on the outlook and a very modest rebound in inflation expectations. BOJ Governor Kuroda and new Deputy Governor Masayoshi Amamiya, who have led the central bank's QQE initiative going back five years, still think that the BOJ should persistently continue current easing policy. New Deputy Governor Masazumi Wakatabe, who had advocated the need for bold easing, had attracted attention before joining the BOJ. In testimony before the Diet, he mentioned appropriate policies that carefully take into account efficacy and side effects. He is unlikely to express differences of opinion with the BOJ governor's proposal. We think the BOJ will outline in its *Outlook for Economic Activity and Prices* bright prospects for inflation reaching its 2% target¹ and decide to stay on hold.

Assessment of economy in policy statement likely to be unchanged

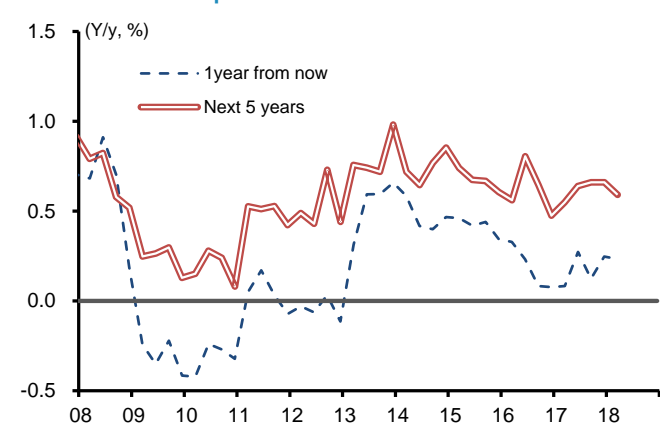
We think the BOJ will stick with its previous assessment of the economy's current situation and outlook in its policy statement. If the BOJ were to change its assessment of any aspect, we think it would be exports, in light of the key economic data released since the last policy meeting. The index of real exports declined M/M in February and March, and the pace of growth appears to be slowing (Chart 1). However, economic growth worldwide is likely to continue to accelerate. Just in its latest March policy statement, the BOJ upgraded its assessment of overseas economies, saying that they "have continued to grow firmly on the whole" (its previous assessment was that they "have continued to grow at a moderate pace on the whole"). In addition, the IMF's *World Economic Outlook*, released on the 17th

Chart 1: Real Export Index



Source: BOJ

Chart 2: Inflation Expectations for Households



Source: BOJ; compiled by Daiwa Securities

¹ For our predictions on the Outlook for Economic Activity and Prices, see our 10 April 2018 report, "[Forecast for April 2018 Outlook Report--Should broadly stick with its scenario](#)" (REPE820).

(Tuesday), mentions "faster growth in the euro area, Japan, China, and the United States." The benefits of overseas demand support the likelihood that domestic production, which has been volatile year to date, will continue to increase moderately in April onward, according to METI's *Survey of Production Forecast in Manufacturing*. In light of the above, we think the BOJ is unlikely to revise its assessment of exports.

The Y/Y rise in the core CPI in February was above 1%. The increase excluding energy prices was up moderately to 0.5%. However, price indicators based on POS data, which cover primarily food and everyday items, show a recent slowdown in the increase to close to 0%. This is one of several indications that inflation still has not picked up. With no notable changes in inflation expectations in the *TANKAN* survey or the *Opinion Survey on the General Public's Mindset and Behavior* (Chart 2), the BOJ will probably maintain its assessment that "inflation expectations have been more or less unchanged."

Reference: BOJ's Assessment of Current Conditions at Previous MPM and Expected Changes in Mar MPM

March 2018	
Current condition	
Japan's economy	"is expanding moderately, with a virtuous cycle from income to spending operating."
Overseas economies	"have continued to grow firmly on the whole."
Exports	"have been on an increasing trend."
Industrial production	"has been on an increasing trend."
Capex	"has continued on an increasing trend with corporate profits and business sentiment improving."
Private consumption	"has been increasing moderately, albeit with fluctuations, against the background of steady improvement in the employment and income situation."
Public investment	"has been more or less flat, remaining at a relatively high level."
Housing investment	"has been weakening somewhat."
Labor market conditions	"have continued to tighten steadily."
Financial condition	"are highly accommodative."
Prices	"The year-on-year rate of change in the CPI is around 1.0%. Inflation expectations have been more or less unchanged."
Outlook	
Economy	"is likely to continue its moderate expansion."
Prices	"The year-on-year rate of change in the CPI is likely to continue on an uptrend and increase toward 2 percent, mainly on the back of the improvement in the output gap and the rise in medium- to long-term inflation expectations."

Source: BOJ, Daiwa Securities

BOJ likely to maintain target amount in policy statement

The BOJ's mention in its policy statement of "an annual pace of increase in the amount outstanding of its JGB holdings of about Y80 trillion" has become nominal for a long time, and with the yield curve under considerable downward pressure, no matter how wide the gap is with the actual pace of purchases, there are still expectations that the BOJ will reduce the amount. It seems that nearly all market participants do not recognize a *raison d'être*, so we would like to see the BOJ omit the target amount at a time when the policy implications would not be second-guessed by the market. However, with the yen strong relative to the rate assumptions companies use for their earnings forecasts, the BOJ may have to move cautiously. We think it is likely to maintain the target amount.

BOJ governor's press conference: ETF purchases, Financial System Report analysis

The governor is likely to face many questions during the press conference about the *Outlook for Economic Activity and Prices*. We would note questions regarding the BOJ's ETF purchases. In a special feature analyzing the BOJ's ETF purchases over three days, starting on 11 April, the Nikkei noted that the BOJ recognizes the side effects of its policies, including price distortions and the difficulties of policy normalization, and that there is a growing sense of urgency about having to lay out a path for policy adjustments while stock prices are high (according to a senior BOJ official). As one proposal for reducing the amount of purchases while minimizing the negative impact on the market, the special feature mentions announcing flexibility on the target amount of purchases and a reduction of the amount when stocks are high. However, we think a shift to such a stance would be inconsistent with the BOJ's explanations so far that the purchases are not intended to support stock prices. We accordingly want to hear what BOJ Governor Kuroda has to say about ETF purchases.²

The BOJ's latest *Financial System Report*, released on the 19th (Thursday), maintains its assessment that "no particular signs of overheating are observed in the current phase of the financial cycle." However, it also notes vulnerabilities of the financial system in connection with a boost in lending to so-called "middle-risk firms" amid a prolonged economic recovery/expansion and a narrowing of loan spreads. It interestingly notes that "bearing in mind any future changes in the macroeconomic environment, financial institutions...need to set appropriate interest rates reflecting the risks involved...[and examine] whether their loan-loss provisions are appropriate." It is somewhat ironic that the BOJ itself does not appear to be managing its policies with future changes in the macroeconomic environment in mind. We want to see whether BOJ Governor Kuroda's remarks indicate any change in the BOJ's recognition of the side effects of its prolonged easing.

² In previous press conferences, he has mainly said that the ETF purchases are a part of the BOJ's easing policy designed to affect risk premiums, not stock prices, make capital markets function better, and help inflation reach the 2% price stability target while the economy continues to grow; that the BOJ will not change its policies on ETFs based on whether stock prices rise or decline (September 2017); that the ETF purchases were decided on as part of its QQE with yield curve control policy; and that if some adjustments are made at some point, adjustments of all aspects would not need to be made at the same time (October 2017).

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[Standard & Poor's]

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