

Daiwa's View

Summary of Opinions at Jun MPM: Opinions on additional easing vs. those on side effects

- Sudden emergence of skepticism about lending in negative rates and reversal rate

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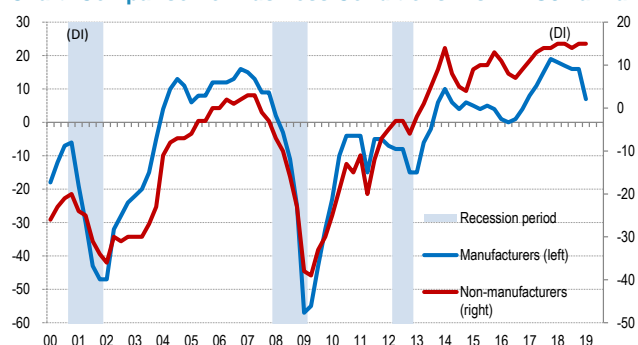
Sudden emergence of skepticism about lending in negative rates and reversal rate

The BOJ released the Summary of Opinions at the Monetary Policy Meeting (MPM) on 19-20 June¹. Prior to the release, the market focused on (1) how much board members were cautious about the economic outlook and (2) the BOJ's stance on additional easing following the global domino-like dovish shift. Meanwhile, the market was also curious about whether the BOJ would clarify its view on the substantial yield downtrend.

First, we found the BOJ's basic scenario on the economic condition—the economy was “likely to continue on a moderate expanding trend,” showing its “resilience².” However, board members said that “various risks entailed in economies warrant attention,” and “risks concerning the global economy have been further tilted to the downside compared to the previous meeting.” Accordingly, there were many opinions that insisted the need to “carefully examine” the developments.

In such a situation, there was the following opinion on prices—“the basic mechanism for a rise in inflation driven by a positive output gap has been operating.” As shown by the fact that as many as four members pointed out the positive output gap, the maintenance of the positive output gap is an anchor to the BOJ.

Chart: Comparison of Business Conditions DIs in BOJ Tankan



Source: BOJ; compiled by Daiwa Securities.

Chart: Output Gap (calculated by BOJ) and Financial Gap



Source: BOJ; compiled by Daiwa Securities.

The section on economic developments stated the fact that “long-term interest rates in Japan currently mark the fourth lowest levels among major economies.” However, no opinions are given regarding this fact (it can be interpreted that Japan's yield downtrend is a natural move as a part of the worldwide yield declines as global dovish dominoes fall).

¹ Release of the content of remarks by board members and government representatives at MPM. This is announced six business days after the meeting.

² The BOJ is pointing out that the business conditions DI for non-manufacturers is at a high level as one indicator regarding the robustness of Japan's economy. Refer to our 28 Jun report [Daiwa's View: Points of Jun BOJ Tankan toward Jul market](#).

◆ Summary of Opinions at MPM on 19-20 Jun 2019

- The Fed and ECB have returned to an accommodative policy stance due to heightening uncertainties regarding the global economy, and 10-year government bond yields have declined on a global basis. In this situation, long-term interest rates in Japan currently mark the fourth lowest levels among major economies after Switzerland, Germany, and Denmark.

Chart: Summary of Opinions at MPM on 19-20 Jun 2019

Opinions on prices		Remarks
1	The year-on-year rate of change in the consumer price index (CPI) is likely to increase gradually toward 2%, mainly on the back of the output gap remaining positive and medium- to long-term inflation expectations rising.	Official opinion
2	Further price rises, such as in food products, have spread widely on the back of increases in personnel expenses and prices of raw materials. Also, the labor market tightening that has lasted for a long period has led to a rise in prices of services. Prices seem to have been firm, and the basic mechanism for a rise in inflation driven by a positive output gap has been operating.	Official opinion
3	With a positive output gap supporting a rise in inflation, the year-on-year rate of change in the CPI has been positive. In order to raise the inflation rate and maintain its level going forward, it is necessary to further raise wages and continue doing so while maintaining reasonably tight labor market conditions.	Necessity for wage hikes
4	While upward pressure of a positive output gap on prices has been maintained, a rise in inflation has been delayed, being offset by the constraining effects on inflation due to a rise in productivity accompanying, for example, firms' labor-saving investment.	Delay in price increases due to supply factors
5	It appears that the convenience store industry has considered terminating late-night services due to a surge in wages for part-time workers on the late-night shift. This will result in a rise in sales per hour, which implies an increase in productivity, but will not lead to price rises. A lot of similar cases across the economy may be the reason behind a delay in price rises.	Delay in price increases due to supply factors
6	An acceleration in inflation has not been seen in Japan with the large impact of the trade friction between the United States and China, while there is still a long way to go to achieve the price stability target of 2%.	Downside risks against main scenario
7	There is a low possibility that the output gap will continue to widen within positive territory, and inflation expectations have remained weak. Against this background, it cannot be judged that the inflation rate will accelerate toward 2%.	Objection to official opinion

Source: BOJ; compiled by Daiwa Securities.

In the latest issue, the number of opinions on monetary policy was ten, slightly lower than the usual. It appears that each board member provided one idea³. In such a situation, we presume that board member Hitoshi Suzuki submitted two opinions regarding the side effects. However, it is naturally difficult for such an opinion to spread under current conditions. Opinions on additional easing are thus gaining momentum.

That said, the number of advocates of additional easing is three and they are limited to proponents of reflation. Two of them advocated that additional easing should be conducted if prices lose upward momentum, not insisting on preemptive measures like the Fed. However, they made in-depth remarks, saying that the BOJ should consider concrete options for additional easing.

In the minutes of the April MPM (announced on 25 Jun), in which forward guidance was clarified, a few members stated that the BOJ needed to thoroughly communicate to the public that it would make policy adjustments without hesitation.

◆ Minutes of MPM on 24-25 Apr 2019

- A few members said that the Bank needed to thoroughly communicate to the public that the proposed measures were necessary responses for continuing with the current powerful monetary easing, and that it would make policy adjustments without hesitation if judged necessary going forward with a view to maintaining the momentum toward achieving the price stability target.

In an interview with Bloomberg on 10 June, BOJ Governor Haruhiko Kuroda said that “the Bank of Japan can deliver more big monetary stimulus if necessary. The BOJ will ease further if momentum toward its 2% inflation target is lost.” We consider this statement to be part of that communication to the public.”

³ Opinions in the “Summary of Opinions” are summarized within 300 words by the members themselves. Accordingly, there is a possibility that some board members did not submit opinions on monetary policy operations in this issue.

Although side effects warrant attention, the governor emphasized that the BOJ doesn't need to act now. This is the BOJ's basic stance including that of the governor and deputy governors.

◆ Summary of Opinions at MPM on 19-20 Jun 2019

Although downside risks warrant attention, it is appropriate for the Bank to continue with the current monetary policy stance given that the main scenario regarding economic activity that Japan's economy is likely to continue on its moderate expanding trend is unchanged and the momentum toward 2% inflation is maintained.

That being said, board member Goushi Kataoka appears to have submitted the following opinion—"it is necessary to further consider in depth the feasibility of a wide range of additional easing measures, as well as their effects and side effects." This includes the word of "further." In other words, it is highly possible that the BOJ is actually considering various options for additional easing (putting aside the probability of actual implementation), alongside its efforts to communicate its stance to the public.

This was recognized by the skeptic opinion on lending in negative rates, which appears to have been submitted by board member Hitoshi Suzuki. This opinion has emerged a little suddenly. It is not clear whether he is arguing against (1) market speculation on deepening of negative interest rates (and the subsequent negative lending rates) or (2) actual options within the BOJ (negative lending rates are out on the table). If the latter is the case, it can be said while various options are actually being discussed within the BOJ, Mr. Suzuki is objecting to the tool in terms of the effects and side effects.

In addition, there is another interesting opinion, in which the side effects are pointed out against additional interest rate declines by using the "reversal rate." (We assume that this opinion was submitted by Mr. Suzuki.) Thus far, he has been insisting via various ways that further yield declines would create a situation where side effects would outweigh the positive effects. This time around, he advocated it by using the concept of the reversal rate.

Chart: Skepticism About Effects from Additional Interest Rate Declines in Summary of Opinions at MPM

		Remarks
MPM at 14-15 Mar 2019	Although pricing in the corporate bond market has been conducted so far based on JGB yields, it is starting to be based on a positive fixed value of interest rates amid negative JGB yields. In such a situation where a virtually zero lower bound exists, there is a possibility that monetary easing effects stemming from an additional decrease in JGB yields will be limited compared to before.	Zero lower bound of corporate bond yields
MPM at 24-25 Apr 2019	There is a possibility that a further decline in interest rates will result in a greater risk of inducing side effects on the real economy, rather than positive effects, considering (1) that there likely is a zero lower bound—contractually and operationally—on financial institutions' interest rates on deposits and loans and (2) the investment and funding structures of the private sector.	Zero lower bound of deposit and lending rates
MPM at 19-20 Jun 2019	While banks' profits have been deteriorating, lending rates seem to be approaching the levels of the so-called reversal rates, which reverse the effects of monetary easing and decrease the amount of bank loans. If base rates for bank loans decline further, there could be a decline in the amount of bank loans, which constitute an important transmission channel through which the effects of monetary policy spread to the real economy.	Reversal rate

Source: BOJ; compiled by Daiwa Securities.

On 21 June, the BOJ circulated the discussion paper "The Reversal Interest Rate" from the 2019 BOJ-IMES Conference. With respect to the timing of this release, market speculation on the BOJ's political intention has been mounting⁴.

⁴ Refer to our 24 Jun report [Daiwa's View: Implication of "Reversal Rate" paper at BOJ-IMES Conference](#).

In thinking of the BOJ's monetary policy, the paper is very thought-provoking. On the other hand, the market thought that the release timing was not so intentional. However, Mr. Suzuki suddenly insisted the opinion on the side effects against yield declines, which might have been reflected the intention of governor and deputy governors. In other words, we think that the BOJ might have intended to warn against yield declines to some extent, given a series of moves including the release of the paper and the timing of its release.

Chart: Summary of Opinions at MPM on 19-20 Jun 2019

Opinions on monetary policy		Remarks
1	Although it will take time to achieve the price stability target, it is necessary to persistently continue with the current powerful monetary easing as the momentum toward 2% inflation is maintained.	Status quo
2	Despite high uncertainties regarding overseas economies going forward, the Bank, in a situation where a policy mix of monetary and fiscal policies are being sustained, should aim to achieve the price stability target by persistently continuing with the current monetary easing policy while paying closer attention than before to the side effects on the functioning of financial intermediation and the market functioning.	Status quo (monitoring of side effects)
3	The Bank should persistently continue with the current monetary policy stance with the aim of continuously encouraging the virtuous cycle of the economy to take hold and achieving the price stability target.	Status quo
4	Although downside risks warrant attention, it is appropriate for the Bank to continue with the current monetary policy stance given that the main scenario regarding economic activity that Japan's economy is likely to continue on its moderate expanding trend is unchanged and the momentum toward 2% inflation is maintained.	Status quo
5	The Bank needs to constantly consider measures that enhance the sustainability of monetary easing.	Enhancement of sustainability of policy framework
6	It is necessary to closely examine the effects of such factors as deterioration in firms' and households' sentiment on the inflation momentum. If there is concern that such momentum will be lost, the Bank should consider implementing necessary policy measures appropriately.	Additional easing should be needed if inflation momentum is lost
7	While central banks have been vigilant regarding the slowdown in the global economy and heightening uncertainties over it, the key to overcoming deflation is for the Bank to maintain its stance of taking some kind of policy responses if some changes emerge in the baseline scenario of the outlook for prices. All policy measures -- including adjustments in short- and long-term interest rates, an acceleration in the pace of expansion in the monetary base, and an increase in the amount of assets to be purchased -- should be deliberated when considering additional easing.	Additional easing should be needed if inflation momentum is lost (concrete options)
8	Amid changes in the external environment such as growing expectations for monetary easing in the United States and Europe, the Bank also needs to strengthen monetary easing. In addition, it is necessary to further consider in depth the feasibility of a wide range of additional easing measures, as well as their effects and side effects.	Consideration of further monetary easing and options of additional easing measures
9	While banks' profits have been deteriorating, lending rates seem to be approaching the levels of the so-called reversal rates, which reverse the effects of monetary easing and decrease the amount of bank loans. If base rates for bank loans decline further, there could be a decline in the amount of bank loans, which constitute an important transmission channel through which the effects of monetary policy spread to the real economy.	Opinion on side effects against effects from additional interest rate declines (reversal rate)
10	Regarding the provision of funds with negative interest rates by central banks to financial institutions, there is a risk that it will not lead to an increase in the amount of bank loans and concern that it will bring about downward pressure on interest rates, depending on developments in economic activity and financial conditions.	Skepticism about lending in negative rates

Source: BOJ; compiled by Daiwa Securities.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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