Daiwa Securities

Daiwa's View

BOJ MPM and *Outlook* report

- BOJ to move in line with global trends of further easing

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp

Economist
Kenji Yamamoto
(81) 3 5555-8784
kenji.yamamoto@daiwa.co.jp
Daiwa Securities Co. Ltd.

BOJ MPM and *Outlook* report

BOJ to move in line with global trends of further easing

At yesterday's monetary policy meeting (MPM), the BOJ decided to maintain the current policy operation stance with a majority vote by the board (7 to 2). In addition, the central bank added the following language in the statement: "In particular, in a situation where downside risks to economic activity and prices, mainly regarding developments in overseas economies, are significant, the Bank will not hesitate to take additional easing measures if there is a greater possibility that the momentum toward achieving the price stability target will be lost."

We think that the addition of the phrase "will not hesitate" was a significant choice in terms of the following three points. First, the BOJ did not make the pointless move of a simple extension of the forward guidance, given the fact that this move by the ECB in June disappointed the market. Second, the central bank gave the impression that it has a stronger bias towards easing than before due to the change in the statement, which has stronger binding force than remarks at a press conference. Third, policymakers left the impression that they would conduct a policy mix which entails an expeditious fiscal policy to address unforeseeable circumstances by adopting the phrase "will not hesitate" in response to remarks by Prime Minister Shinzo Abe at the Council on Economic and Fiscal Policy on 29 July. The market clearly understood the BOJ's stance as moving in line with global trends of further easing.

◆ **Remark by Prime Minister Shinzo Abe at Council on Economic and Fiscal Policy on 29 July 2019**

・Amid increasing concerns about the impact of downside risks emanating from abroad on Japan's economy, we need to take all possible measures to ensure the economic recovery trends. If risks emerge, we will take expeditious and full-blown macroeconomic measures, without hesitation.

As the latest BOJ statement does not include the term "or lower" which was used by the ECB to signal a rate cut to the market, yesterday's BOJ action itself aimed at only giving the impression of an aggressive stance toward easing. We do not think that this will have that large of a direct impact on the JGB market.

However, if factors emanating from abroad put downward pressure on the economy, we can say that the reaction of short-term/intermediate yields will be more inclined towards the downside than before. Going forward, the market will continue to focus on whether forward guidance-related language will be added when the BOJ extends the guidance again in line with shortening of the time frame.

In addition, the BOJ slightly lowered its price projections for FY19 and FY20 in the *Outlook for Economic Activity and Prices* report (*Outlook* report), as expected. However, according to policy board members' risk assessments on price projections, we found that almost all members (seven for FY19 and eight for FY20) think that "risks are skewed to the downside." This suggests that further downward revision to price projections will be unavoidable going forward.

◆ Statement at July BOJ MPM (30 July 2019)

・In particular, in a situation where downside risks to economic activity and prices, mainly regarding developments in overseas economies, are significant, the Bank will not hesitate to take additional easing measures if there is a greater possibility that the momentum toward achieving the price stability target will be lost.

The background factors of these downside risks on price projections lie in "price specific factors" which have been pointed out by the BOJ thus far and growing downside risks to prices via a path of "economic downside risks."

◆ *Outlook* report (30 July 2019)

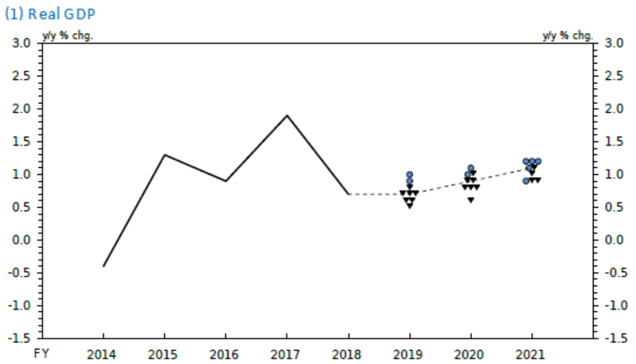
・With regard to risks to economic activity, the downside risks concerning overseas economies in particular are significant. If these risks materialize, there is a possibility that prices also will be affected to some extent.

Needless to say, the risks to economic activity are the downside risks concerning overseas economies. In the *Outlook* report, this is pointed out as the first risk factor as in previous reports. This time around, the phrase "uncertainties regarding the effects of protectionist moves in particular have been heightening" was added in this paragraph.

Despite emphasizing these downside risks, the BOJ slightly lowered its growth forecasts only for FY19 and FY21, keeping the FY20 forecast unchanged. However, similar to price projections, policy board members' risk assessments on economic projections showed that most members are aware of downside risks as the number of members assuming large downside risks has increased from five in the previous report to seven for both FY19 and FY20 (and also up from two to four members for FY21).

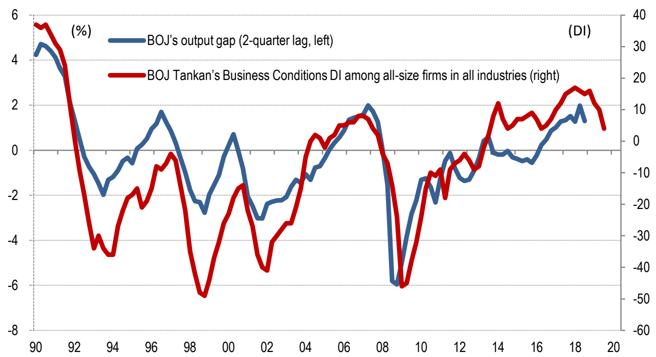
If the growth rate declines further, it would be lower than the potential growth rate, which is estimated at the upper 0% range. In short, a yellow light would turn on for an output gap, which indicates price momentum[1].

Chart: Policy Board Members' Risk Assessments in Economic Projections



Source: Extract from BOJ Outlook report.

Chart: BOJ's Business Conditions DIs in Tankan and Output Gap



Source: BOJ; compiled by Daiwa Securities.
Note: Latest Business Conditions DI indicates forecast DI.

[1] In our 8 July 2019 report *Daiwa's View: BOJ will be patient about yield declines*, we forecast the output gap in light of forex factor.

Regarding the output gap, the BOJ changed its assessment to "substantially positive" from "widened within positive territory on average" in the previous report. Thus, the widening move of the "excessive" reading has stopped. With respect to the outlook, the central bank stated that the output gap "is expected to remain so" (substantially positive), using a similar expression as the previous report. However, as we stated in the previous paragraph, a yellow light has turned on for the outlook.

In other words, the phrasing "if price momentum is lost" would imply a shift of the output gap to negative territory. However, the expression "if there is a greater possibility that the momentum ... will be lost" can be interpreted as the timing when the output gap shifts from the "substantially positive" level to a narrowing trend. One yardstick for the output gap shifting to a narrowing trend is "economic growth lower than the potential growth rate."

◆ **BOJ governor Haruhiko Kuroda (30 Jul 2019)**

・In the latest statement, we went a step further by saying that we would take additional easing measures without hesitation if there were greater concerns that momentum would be lost, even if it had not yet been lost, rather than simply saying that we would take additional easing measures without hesitation if there were a greater possibility that momentum would be lost. Previously, we said only that we will consider acting without hesitation if the economy loses momentum for achieving our price goals. The possibility is increasing that the risks of overseas economies will spread. The new language means that we would take action if there were a greater possibility that the momentum for achieving our price goals would be lost. We can say that we have become more positive about additional easing. While there is room for discussion regarding the meaning of "preventive," our stance can be said to be "preventive" in terms of the phrasing "possibility that the momentum … will be lost."

This time, board member Goushi Kataoka started to officially argue that it was better to strengthen easing by lowering the short-term policy rate. He appears to have changed his opinion regarding the deepening of the negative interest rate, as he recognized that his former proposals (volume expansion, flattening of long-term/superlong yields) had limitations and side effects. Since the new proposal also entails strong side effects, other board members are unlikely to agree to this soon. However, we think that the possibility of a deepening of the negative interest rate has certainly increased compared to before as one tool that could be used now that the BOJ will "not hesitate to take additional easing measures."

◆ **Statement at July BOJ MPM (30 July 2019)**

・Board member Goushi Kataoka dissented, considering that it was desirable to strengthen monetary easing by lowering the short-term policy interest rate.

↑

◆ **Statement at January BOJ MPM (25 Jan 2019)**

・Board member Goushi Kataoka dissented, considering that, with heightening uncertainties regarding developments in economic activity and prices going forward, it was desirable to strengthen monetary easing so that yields on JGBs with maturities of 10 years and longer would broadly be lowered further.

Daiwa Securities

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

The Name of the Credit Rating Agencies Group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

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[Fitch]

The Name of the Credit Rating Agencies group, etc

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The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

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May 2018

IMPORTANT

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

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 (including tax) 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.

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The Financial Futures Association of Japan
Japan Investment Advisers Association
Type II Financial Instruments Firms Association