Daiwa Securities

Daiwa's View

Speech by BOJ board member Hitoshi Suzuki

➢ Naturally objecting to additional easing for now

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Naturally objecting to additional easing for now

On 29 August, the BOJ released a speech by BOJ board member Hitoshi Suzuki. This is his first speech since 28 February 2019, six months ago. In the section covering monetary policy operations, he explained the developments under the yield curve control policy—modification in July 2018, clarification of forward guidance in April 2019, and the addition of the phrase "will not hesitate" in the latest monetary policy meeting (MPM) in July. He then stated an official opinion that "if we concretely consider and take additional measures, we will consider appropriately by comparing the benefits and side effects in the circumstances of the moment." On top of this, he stated his own opinion in a section with the subhead "the benefits and side effects of monetary easing under the low interest rate environment." Specifically, he strongly focused on the side effects of monetary easing. That said, this is not surprising as his stance has been consistent. A characteristic point in this section is that he covered almost all side effect-related opinions in the *Summary of Opinions* reports at four MPMs after his previous speech in February[1][2]. Conversely, it turned out that opinions emphasizing the side effects were submitted by Mr. Suzuki as expected when the anonymous *Summary of Opinions* reports were issued.

Chart: Summary of Opinions at MPMs

	Opinions on Side Effects of Monetary Policy, Presumed to be Mr. Suzuki's Opinion	Remarks
MPM on 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 on 24-25 Apr 2019	Looking at recent economic and financial developments, we are in a situation where it is more necessary to (1) pay attention to the time frame in which monetary policy effects spread to the real economy and to that in which their side effects strengthen in a cumulative manner, and (2) cautiously weigh up the positive effects and side effects.	Cautious comparison between positive effects and side effects
MPM on 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 is likely a zero lower bound—contractually and operationally—on financial institutions' interest rates on deposits and loans and (2) the investment and funding structures in the private sector.	Zero lower bound of deposit and lending interest rates
MPM on 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
MPM on 19-20 Jun 2019	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.	Skeptical view about with negative lending rates
MPM on 29-30 Jul 2019	When considering policy responses, it is necessary to examine both their effects and side effects. In doing so, it is important to carry out careful examination and design while taking into account the risk that the effects may be impaired by the side effects.	Importance of carrying out careful examination and design, given benefits and side effects
MPM on 29-30 Jul 2019	Given the time frame in which the side effects of monetary easing accumulate for a long time, it is necessary to consider monetary policy measures more carefully with a view to preventing financial instability while examining changes in financial institutions' risk-taking stance and the effects of a decline in interest rates on their profits and lending attitudes.	Cumulative effects of side effects from monetary easing

Source: BOJ; compiled by Daiwa Securities.

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[1] Refer to our 8 Aug report *Daiwa's View: Summary of Opinions at July BOJ MPM*.
[2] In speech, he did not touch only on skeptic view on negative lending rate.

In short, Mr. Suzuki's speech can be summarized as "monetary policy effects due to an additional decline in JGB yields are limited, while the risk of financial system destabilization is accumulating due to the prolongation of low interest rates."

Moreover, he recognized that "it is becoming more important to conduct monetary policy, taking account of not only price stability but also financial system stability." This naturally implies that he is objecting to further additional easing. In fact, he clearly stated that "additional easing is unnecessary at the moment" at a post-speech press conference.

As it was confirmed that almost all opinions emphasizing the side effects in the *Summary of Opinions* reports were submitted by Mr. Suzuki as mentioned above, he appears to be fighting on alone in the policy board in some way.

Regarding the options of additional easing, he adhered to the official opinion at a press conference, saying that "there are various responses such as a cut in the short-term policy rate, a reduction in the operational target of the long-term rate, an increase in asset purchases, and acceleration of the expansion pace of the monetary base. A combination or application of them is possible." On the other hand, he stated that "we are not having concrete discussions at the moment." Asked if additional easing should be combined with a scheme to ease the side effects or not, he replied that "it should be conducted under the assumption that the benefits will outweigh the side effects."

With respect to a more direct question about the pros and cons of a further cut in negative interest rates, he stated that "we need to consider very carefully whether the benefits will outweigh the side effects." In addition, he recognized that the side effects of the deepening of negative rates alone are too strong, in a hypothetical way—"if negative rates are reduced further, I doubt if benefits of the measure alone will outweigh the side effects."

Regarding the BOJ's consensus on the additional easing, we would like to confirm messages from another board member who submitted a neutral opinion in the *Summary of Opinions* of the July MPM—"it is necessary to consider the pros and cons of various easing measures that involve such factors as quantity, quality, and interest rates." Moreover, the opinion that "it is necessary to examine carefully whether there is a need for further monetary easing in this situation" surfaced in the July MPM. We think that this is the current stance of the governor and deputy governors.

◆ Summary of Opinions at MPM on 29-30 Jul 2019

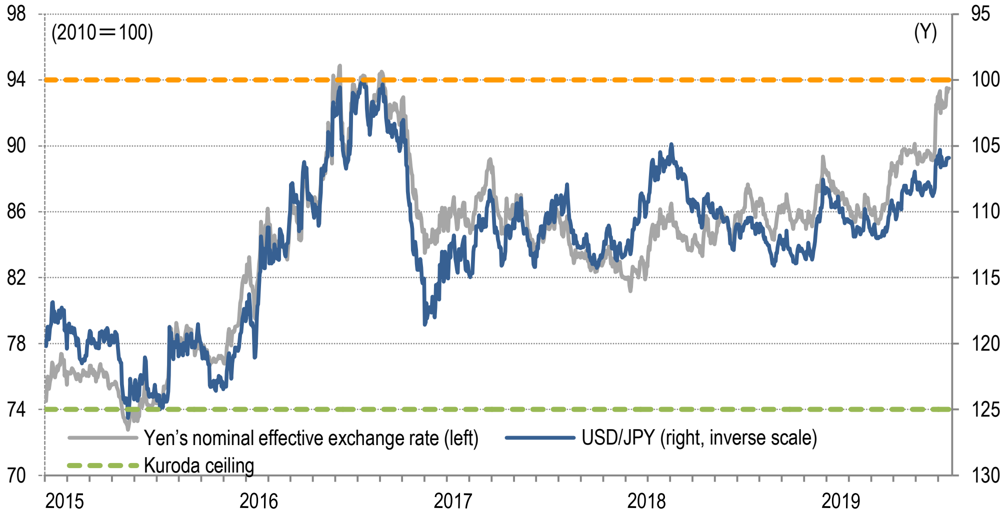
・The degree of monetary accommodation in Japan seems to have been already greater than that in the United States and Europe. It is necessary to examine carefully whether there is a need for further monetary easing in this situation. At least for now, it is important to persistently continue with the current extremely powerful monetary easing for as long as possible.

However, as US-China trade tension has escalated since the July MPM, the yen has already appreciated by around 5% on an effective exchange rate basis. In its January 2016 *Outlook for Economic Activity and Prices* report, the BOJ estimated the effect of 10% yen depreciation in the vector auto-regression (VAR) model[3]. The report showed that a 10% yen depreciation shock boosted the output gap by slightly less than 1% in four quarters.

Based on this result, the current 5% yen appreciation shock is expected to lower the output gap by 0.4-0.5% in the future. Since the April MPM, the yen has strengthened by 10%, which could have a significant impact also on the BOJ's economic and price projections. We await more messages from the BOJ reflecting this situation—whether its judgments on "momentum of price stability" and the "pros and cons" of additional easing will be unchanged.

[3] Refer to our 8 Jul report *Daiwa's View: BOJ will be patient about yield declines*.

Chart: Chart: USD/JPY and Yen's Nominal Effective Exchange Rate



Source: BOJ; compiled by Daiwa Securities.

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2) Establishment of control systems (fairness of the rating process, and prevention of conflicts of interest, etc.).
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[Standard & Poor's]

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[Moody's]

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[Fitch]

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May 2018

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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.

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