

Daiwa's View

BOJ to examine economic/price developments at Oct MPM

- Leaning toward additional easing, but “assessment” differs from “examination” in BOJ language

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Status quo kept at Sep BOJ MPM; opinion for lowering short-term policy rate remained in minority

Measures to avoid excessive yield decline may be regarded as monetary tightening

Some board members appear to be advocating measures to address excessive yield decline, combined with deepening of negative rates

BOJ to “examine” economic/price developments at Oct MPM, while leaning toward additional easing

As expected, the BOJ kept its current monetary policy unchanged at the 18-19 September monetary policy meeting (MPM) by a 7-2 majority vote (board members Yutaka Harada and Goushi Kataoka dissented). Mr. Kataoka objected to the decision, insisting on lowering the short-term policy interest rate. However, his opinion remained in the minority. Triggered by BOJ governor Haruhiko Kuroda's interview article on 5 September, I recognized that the focus of policy debate has shifted from additional easing options to the excessive yield decline in the superlong zone. However, as the media continued to report speculation also on further lowering of negative rates until immediately before the MPM, I had to doubt my recognition until the MPM result was announced. If the BOJ takes action in consideration of only the excessive yield decline in the superlong zone, it may be regarded as monetary tightening. In order to avoid such recognition, some board members appear to be advocating measures combined with additional easing steps by deepening negative rates (incl. measures to address side effects). Regarding media reports since the beginning of September, I felt that the BOJ has challenges in its method of sending messages. However, the BOJ showed the waymark by adding new language in the final part of the latest statement.

★6th paragraph of statement at Sep MPM (19 Sep 2019)

Given that, recently, slowdowns in overseas economies have continued to be observed and their downside risks seem to be increasing, the Bank judges that it is becoming necessary to pay closer attention to the possibility that the momentum toward achieving the price stability target will be lost. Taking this situation into account, the Bank will reexamine economic and price developments at the next MPM, when it updates the outlook for economic activity and prices.

BOJ admitted that it needed to pay closer attention than in Jul; moving closer toward additional easing

In BOJ language, “assessment” differs from “examination”

As usual, the language is lengthy probably because it is a product of the compromise to gain the agreement of board members. Briefly speaking, the BOJ moved its judgment closer to additional easing as it admitted that it needed to pay closer attention (also to financial market developments) than in July because overseas factors may increase downside risks. The central bank stated that it would decide the policy at the next MPM to be held on 30-31 October, given the economic/price developments shown in the October *Outlook for Economic Activity and Prices* report (*Outlook* report). However, it did not say that it will change the policy, meaning that the option of doing nothing new is left as a result of reexamination. At the press conference, Gov. Kuroda stated that the central bank is “leaning more toward additional easing than in the previous meeting.” However, asked whether there is a chance the BOJ will not conduct additional easing at the next MPM, he replied “exactly,” while smiling. In BOJ language, the word “assessment” is used under the assumption of policy changes, but “examination” is always implemented, having a clear difference.

Sep statement superficially strengthened stance for additional easing

In September, the ECB Governing Council adopted a further monetary easing program that includes all possible policy options. On the 18th, the Fed decided to cut interest rates for the second meeting in a row. To avoid the impression that only the BOJ took no action against downside risks of the global economy, the central bank appears to have formulated the aforementioned description in the statement. I think that the BOJ just strengthened its superficial stance for additional easing, but market reactions factored in additional easing. Although the BOJ is preparing for additional easing, it does not think that the framework needs to be changed, according to Mr. Kuroda.

Our eyes on remarks at speeches by Mr. Kuroda on 24th and by Ms. Masai on 25th

The BOJ has yet to decide on the policy. I think that there is a slight gap between the BOJ's intention and market understanding. We need to understand the BOJ's real intention via a speech/Q&A by Mr. Kuroda on 24 September and those by policy board member Takako Masai on 25 September. We intend to carefully check their remarks.

Forward guidance also to be revised in Oct

This time around, the BOJ did not revise forward guidance. It did not change threshold indicators or remove the calendar timing (spring 2020), unlike the case of the recent ECB Governing Council. We presume that the BOJ will extend or revise the forward guidance alongside the release of the October *Outlook* report.

At Oct MPM, additional easing not done deal and fundamentals-based judgment important

This is because, at the October MPM, (1) additional easing is not a done deal and (2) it is important to make a judgment based on fundamentals. Since August, the US economy has remained solid and there have been signs of bottoming in the global economy in some areas (emerging nations, northern Europe). Following the Swedish central bank on 6 September, the Norwegian central bank also decided to raise interest rates on 19 September. At the press conference, Mr. Kuroda reiterated the downside risks of overseas economies, but he also stated that "as US consumption is strong, a recession is unlikely anytime soon." The possibility that the Fed's continuous rate cut period will shorten would serve as a tailwind for the BOJ, which has only a limited amount of ammunition. Although the US partially imposed a fourth round of tariffs on Chinese imports on 1 September, trade talks are expected to proceed. On the other hand, the US plans to levy tariffs on Chinese smartphones and PCs from 15 December, which may lead to front-loaded exports from China (factor to temporarily boost economy). Mr. Kuroda also pointed out that the IT cycle has bottomed a little bit. The baseline is a moderate recovery scenario.

Baseline is moderate recovery scenario; downside risks of overseas economy checked carefully

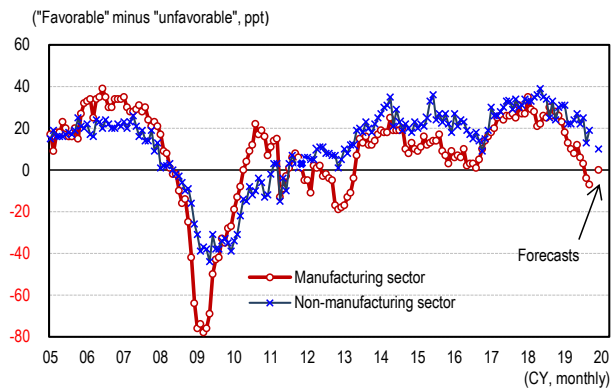
Impacts on corporate earnings and capex to be confirmed in Sep Tankan

Amid increasing downside risks for the global economy, the BOJ will confirm the negative impacts on corporate earnings and capex in the September Tankan to be announced on 1 October (base date to respond to survey is around 10 Sep). Given the result of the Reuters Tankan (similar statistics; Chart 1), we forecast that the business conditions DI among large manufacturers will decline to around zero. In the non-manufacturing sector, a drop after the consumption tax hike is a concern. Meanwhile, the historical pattern shows a high possibility that capex will be revised downward in the September survey (Chart 2). Key is the degree of the downgrade. Regarding this, the BOJ must check the impact of downside risks on capex via thorough interviews with companies. Updated information will be shown by Regional Economic Report (*Sakura* report) to be announced on 15 October. If Japan's economy is not projected to stall despite a slight slowdown in hard data, the BOJ may be able to maintain its baseline scenario. In short, the point is whether the BOJ can describe Japan's economy as solid despite downside risks for the global economy.

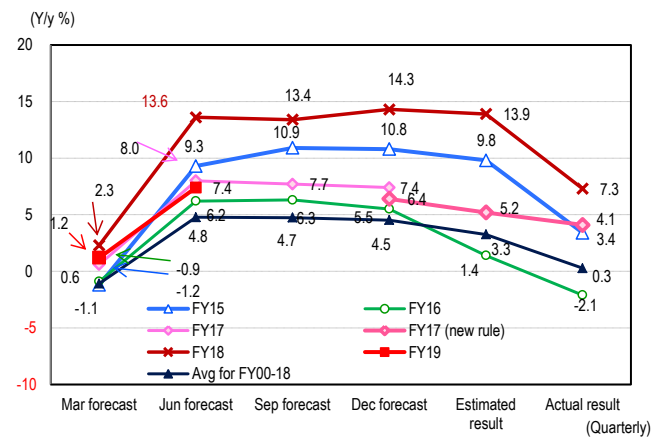
Japan's economy should be solid unless hard data stalls despite softening of sentiment indicators

Key is whether financial market can avoid confusion before Oct MPM

In October, the IMF will announce its *World Economic Outlook* and the consumption tax rate will be raised in Japan. However, it is difficult to fully examine the impact of the consumption tax hike as only September data is available in October. Although the scenario in October's *Outlook* report is important, a key for monetary policy judgment is whether the financial market can avoid confusion (continuation of USD/JPY below 100) amid overseas uncertain factors (such as US-China trade talks, Brexit, tension in Middle East).

Chart 1: Business Sentiment DI in Reuters Tankan


Source: Reuters; compiled by Daiwa Securities.
 Note: Based on 400 firms.

Chart 2: Capex Plan in BOJ Tankan (large firms in all industries)


Source: BOJ; compiled by Daiwa Securities.

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[Standard & Poor's]

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- 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.

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