Daiwa Securities

Daiwa's View

Summary of Opinions at Oct MPM

- ➢ Vague forward guidance probably playing a role in maintaining easing expectations

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Summary of Opinions at Oct BOJ MPM

Vague forward guidance probably playing a role in maintaining easing expectations

The BOJ announced the Summary of Opinions at the Monetary Policy Meeting (MPM) on 30-31 October (summary report hereafter in this report). While the BOJ held off on conducting additional easing at the October MPM, it replaced its forward guidance for the policy interest rates with a new one. Specifically, the time frame was linked with inflation momentum—"as long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost." At the same time, the downward bias of the policy rates was reflected in the forward guidance—"the Bank expects short- and long-term interest rates to remain at their present or lower levels."

Chart: BOJ's Forward Guidance

Three-layered forward guidance		
Policy interest rates	Short- and long-term interest rates to remain at their present or lower levels	As long as it is necessary to pay close attention to the possibility that the momentum toward achieving the price stability target will be lost
YCC	Quantitative and Qualitative Monetary Easing with Yield Curve Control	Aiming to achieve the price stability target of 2%, as long as it is necessary for maintaining that target in a stable manner
Quantity	Expansion of monetary base	Until y/y increase in the observed CPI (all items less fresh food) exceeds 2% and stays above the target in a stable manner

Time frame →

Source: BOJ; compiled by Daiwa Securities.

Before the announcement of the summary report, a focal point was how the October summary report would show the distance between the forward guidance that has now factored in the rate cut bias and actual additional easing (deepening of negative interest rates). At the October MPM, the forward guidance was strengthened, but measures to curb excessive yield declines in the superlong zone were not described in the statement, which came as a surprise. Whether the meeting had a debate on such measures was another focal point.

Based on our reading of the summary report, the former feels a lot like a communication strategy for maintaining expectations of additional easing, rather than an implication of a rate cut in the near future like the ECB, although a rate-cut bias was added to the forward guidance. As for the latter, we were unable to confirm the spread of such opinions in the summary report. Such sentiments were only expressed by a board member who has already been very concerned about the side effects of monetary easing.

The topics in the October *Outlook for Economic Activity and Prices* report (*Outlook* report) were the delay in the recovery of overseas economies, the risk of its impact on domestic demand, and the assessment of inflation momentum. In this regard, the summary report reflected the opinion of many that "the impact of the slowdown in overseas economies is expected to be limited on the back of steady domestic demand thus far," similar to the *Outlook* report. Regarding the inflation momentum, the outlook that the possibility of the inflation momentum being lost is unlikely to increase further is the mainstream based on the assumption of a limited impact on domestic demand. However, the forward guidance was replaced with a new one as the board judged that "it is necessary to continue to pay close attention to the possibility that the inflation momentum will be lost" in situations in which the downside risk of overseas economies appears to be increasing.

◆ Summary of Opinions at MPM on 30-31 Oct 2019

・Japan's economy has maintained its moderate expansion owing to steady domestic demand and the limited effects of a decline in external demand, despite a continuing slowdown in overseas economies and heightened uncertainties over the future.

The reason for introducing the new forward guidance is summarized in the opinion that "it is appropriate to relate it to the inflation momentum from the viewpoint of consistency with previous communications. It is also appropriate to clarify that the Bank's policy stance is further tilted toward monetary accommodation by indicating that there will be a downward bias in the policy rates." This appears to have been submitted by the Governor, deputy governors, or those who share similar opinions with them. Here, "the viewpoint of consistency with previous communications" points to the strengthened BOJ stance of sending messages since April 2019 and gradual additions to the language in the statement.

◆ Statement at MPM on 30 Jul 2019

・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.

That said, it is important to read the October summary report by comparing it with documents from the September MPM, especially recently-released minutes. At both meetings, members who insisted on additional easing were limited to proponents of reflation. However, their insistence on additional easing at the October MPM was more toned down compared to the September MPM.

As a matter of course, this is largely because of the following factors: (1) solid data confirmed by the BOJ Tankan and BOJ branch managers' meeting reports, both of which were released after the September MPM, (2) the easing of tensions surrounding US-China trade talks and geopolitical risks, and (3) the improvement of the market environment, reflecting (1) and (2).

In fact, the September summary report showed that even a member putting relatively high emphasis on the side effects was also leaning toward additional easing through his opinion that it is "necessary to consider desirable policy responses while paying attention to the side effects." However, the October summary report showed the opinion by the same member that "the Bank should maintain the current monetary easing policy …and the Bank could show its policy stance by, for example, revising the forward guidance." At the same time, he said that "The Bank should continue with its monetary policy conduct, while also taking account of the side effects on the financial system."

◆ Summary of Opinions at MPM on 18-19 Sep 2019

・It is appropriate to maintain the current monetary easing policy for the time being. However, given the concern that the delay in the recovery in overseas economies will have a negative impact on Japan's economic activity and prices, it is necessary to consider desirable policy responses while paying attention to the side effects.

◆ Summary of Opinions at MPM on 30-31 Oct 2019

・As the inflation momentum has not been lost, the Bank should maintain the current monetary easing policy. That said, it is important to continue closely examining developments in the global economy, and the Bank could show its policy stance by, for example, revising the forward guidance. The Bank should continue with its monetary policy conduct, while also taking account of the side effects on the financial system.

In other words, the wording "desirable policy responses while paying attention to the side effects" stated by this member in September led to common ground regarding the strengthening of forward guidance, instead of actual additional easing, partly thanks to improvement in the market environment. Of course, this forward guidance has paved the way for deepening of negative interest rates in the future. Meanwhile, this has significant meaning in terms of the BOJ's communication strategy. In short, its role in maintaining the market's easing expectations is greater. Unless we see a resurgence of the risk-off mode and trade/geopolitical risks seen during August and September, the market is likely to lose interest in additional easing by the BOJ.

Meanwhile, partly because the BOJ set aside additional easing as an option for later use, concerns about excessive yield declines in the superlong zone and prolonged negative interest rates were expressed by only some members. Specifically, these opinions appear to have been submitted by board member Hitoshi Suzuki, who has been vigorously pointing out the side effects of monetary policy thus far. The summary reports at the last two meetings have been characterized by a member, probably Mr. Suzuki, touching on market trends in the Economic Developments section and then stating his opinions on the side effects in the Opinions on Monetary Policy section.

Also, at the October meeting Mr. Suzuki pointed out the distressed condition of domestic fund management institutions assuming a global "Low for Long" environment, saying that "The declining trend in interest rates is likely to continue because it seems that an increase in the purchases of bonds with higher yields by investors worldwide has brought about a spiral of globally low interest rates."

Specifically, he was concerned about the current condition in which negative interest rates have been eroding profitability at financial institutions, stating that "If long-term yields remain at around current levels for a long period, the life insurance industry could face difficulties in maintaining the provision of insurance products such as whole life insurance and annuity insurance, for both of which there is strong public demand, and thereby may not fulfill its social responsibility. In addition, regarding investment in yen-denominated bonds, if interest rates are lowered by 0.1 percentage point, pension funds and investment trusts could lose profits of tens of billions of yen. … it can be said that pension funds and investment trusts effectively bear the cost of the negative interest rate."

◆ Summary of Opinions at MPM on 30-31 Oct 2019

・If long-term yields remain at around current levels for a long period, the life insurance industry could face difficulties in maintaining the provision of insurance products such as whole life insurance and annuity insurance, for both of which there is strong public demand, and thereby may not fulfill its social responsibility. In addition, regarding investment in yen-denominated bonds, if interest rates are lowered by 0.1 percentage point, pension funds and investment trusts could lose profits of tens of billions of yen. Also, half of the amount outstanding of the Policy-Rate Balance, to which a negative interest rate is applied, is trust banks' assets entrusted by pension funds and investment trusts, and thus it can be said that pension funds and investment trusts effectively bear the cost of the negative interest rate.

However, other members did not follow suit. On the contrary, there was a counterargument from a member considered a proponent of reflation that "Monetary policy should be considered in terms of the relationship with the economy as a whole, rather than banks' business conditions." According to the minutes of the September MPM, one member had a similar opinion. In addition, a few members pointed out that "structural problems, which would have an impact on financial institutions' business environment, and the effects of monetary easing should be discussed independently of each other." Opinions placing responsibility on financial institutions' operations and structural problems are somewhat dominant.

◆ Minutes of MPM on 18-19 Sep 2019

・A few members pointed out that structural problems, which would have an impact on financial institutions' business environment, and the effects of monetary easing should be discussed independently of each other. A different member noted that, with regard to the effects of monetary easing, including a negative interest rate policy, their impact on the overall economy should be considered first, rather than on banks' business conditions.

Finally, the October summary report expressed an opinion regarding the requirements of forward guidance that "It is desirable that the forward guidance incorporates the following three points: (1) it shows a stance that a decline in the inflation rate is not acceptable; (2) its context is specific; and (3) the Bank commits itself to conducting monetary policy based on concrete conditions."

However, the situational requirement of the forward guidance is by no means concrete, making the time frame significantly vague. Although the BOJ is likely to maintain the current policy in the near term, we need to note that monetary policy could shift to either an accommodative or normalization direction under the current forward guidance, depending on the BOJ's interpretation of the "possibility that the momentum toward achieving the price stability target will be lost" and "as long as it is necessary to pay close attention to the possibility."

◆ Summary of Opinions at MPM on 30-31 Oct 2019

・It is desirable that the forward guidance incorporates the following three points: (1) it shows a stance that a decline in the inflation rate is not acceptable; (2) its context is specific; and (3) the Bank commits itself to conducting monetary policy based on concrete conditions.

Chart: Summary of Opinions at MPM on 30-31 Oct 2019

Opinions on Monetary Policy	Remarks
There has been no further increase in the possibility that the momentum toward achieving the price stability target will be lost. It is appropriate to maintain the current guidelines for market operations and asset purchases.	Status quo
As the inflation momentum has not been lost, the Bank should maintain the current monetary easing policy. That said, it is important to continue closely examining developments in the global economy, and the Bank could show its policy stance by, for example, revising the forward guidance. The Bank should continue with its monetary policy conduct, while also taking account of the side effects on the financial system.	Status quo (Consideration to side effects)
Given that it will still take time to achieve the price stability target, the Bank should communicate clearly its stance of continuing with powerful monetary easing.	Importance of sending messages to the public
With regard to the forward guidance, it is appropriate to relate it to the inflation momentum from the viewpoint of consistency with previous communications. It is also appropriate to clarify that the Bank's policy stance is further tilted toward monetary accommodation by indicating that there will be a downward bias in the policy rates.	Strengthening of forward guidance
It is desirable that the forward guidance incorporates the following three points: (1) it shows a stance that a decline in the inflation rate is not acceptable; (2) its context is specific; and (3) the Bank commits itself to conducting monetary policy based on concrete conditions.	Requirements of forward guidance
Although the inflation momentum is judged as being maintained at present, it cannot be said that households' and firms' inflation expectations have been robust, and thus closer attention should continue to be paid. It is necessary for the Bank not to hesitate to take additional easing measures if there is a greater possibility that the inflation momentum will be lost.	Additional easing without hesitation in case of greater possibility that the inflation momentum will be lost
In the current situation where risks are skewed to the downside, the Bank should continue to examine whether additional monetary easing will be necessary. Japan's economy is susceptible to developments in overseas economies. Also, inflation expectations in Japan are not anchored to the price stability target of 2 percent, and the observed inflation rate is far from the target. Thus, the claims for conducting preventive monetary easing would be most appropriate for the case of Japan. In addition, the Bank should seriously prepare for the next economic downturn as one of the risk scenarios. In doing so, it will become more important to not only conduct monetary policy but also enhance cooperation with the government in terms of fiscal and other policies.	Consideration of need of additional easing measures Preventive policy responses Further tie-up with fiscal policy
Monetary policy should be considered in terms of the relationship with the economy as a whole, rather than banks' business conditions. Banks' net income increased for several years following the introduction of quantitative and qualitative monetary easing (QQE), mainly due to an increase in sales gains on bonds and stocks as well as a decrease in credit costs. Some banks increased the number of employees, partly reflecting a rise in profits, but the rise in net income through the aforementioned factors is not necessarily attributable to the increase in the number of employees. It can be said that the important issue is how to use those employed to increase profits.	Positive view on QQE and objection to criticism about side effects
If long-term yields remain at around current levels for a long period, the life insurance industry could face difficulties in maintaining the provision of insurance products such as whole life insurance and annuity insurance, for both of which there is strong public demand, and thereby may not fulfill its social responsibility. In addition, regarding investment in yen-denominated bonds, if interest rates are lowered by 0.1 percentage point, pension funds and investment trusts could lose profits of tens of billions of yen. Also, half of the amount outstanding of the Policy-Rate Balance, to which a negative interest rate is applied, is trust banks' assets entrusted by pension funds and investment trusts, and thus it can be said that pension funds and investment trusts effectively bear the cost of the negative interest rate.	Side effects of prolonged low interest rates and negative interest rates

Source: BOJ; compiled by Daiwa Securities.

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[Standard & Poor's]

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