Daiwa's View

Next focal point for BOJ is Apr *Outlook Report*

- Our eyes on newly established price projection for FY22

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First MPM this year uneventful

At this year's first Monetary Policy Meeting (MPM) on 20-21 January, the BOJ decided to maintain the status quo by a 7-2 majority vote. Board member Goushi Kataoka objected to the decision, insisting on lowering the short-term policy interest rate for a fifth straight meeting. However, his opinion remained in the minority. The BOJ is expected to persist with monetary easing in 2020, holding a balance between the policy effects and side effects. In the near term, the stance of paying close attention to downside risks on overseas economies will be unchanged.

Jan *Outlook Report*: price outlooks lowered despite upward revision to growth outlooks

Gov't, BOJ, private institutions' views differ on effects of economic measures

In its January *Outlook for Economic Activity and Prices* report (*Outlook Report),* the BOJ raised GDP growth rate projections (median) for FY19-21 (Chart). Due to a downward revision to the final FY18 GDP, the BOJ expects FY19 growth to beat the potential growth rate if a recovery is confirmed in the Jan-Mar quarter, despite a meaningful contraction in the Oct-Dec quarter. For FY20, +0.7% growth projection as of October 2019 was lifted to +0.9% on expected boosts from the government's economic stimulus measures. That would still be lower than the government's +1.4% growth forecast, but much stronger than private-sector forecasts. Impacts of the stimulus measures are expected to span several years, which is likely to boost FY21 growth. Therefore, the +1.0% projection as of October 2019 was lifted to +1.1% (avg. growth forecast in Jan ESP Forecast Survey: +0.51% for FY20 and +0.68% for FY21). FY20-21 projections appear somewhat optimistic.

No change to price scenario

Price projections from FY20 optimistic, but 2% target will not be hit

Flexible interpretation of price target should be considered in discussing exit strategy

Turning to price forecasts (median, core CPI y/y incl. impact of consumption tax hike), the BOJ now expects +0.6% in FY19, +1.0% in FY20, and +1.4% in FY21, all of which were cut by 0.1ppt each from the figures as of October 2019 (Chart). The downward revision to the FY19 forecast reflects the lack of momentum to passing the higher tax rate on to product prices. Output gap improvements are likely to continue, owing to sustained growth above the potential growth rate. However, the initial CPI forecasts were bullish and the correlation between the economy and prices is weakening, which appears to have led to the slight downward revisions. Given the private-sector average forecasts (ESP Forecast Survey in Jan) of +0.63% in FY19, +0.59% in FY20, and +0.62% in FY21, the BOJ's scenario that the CPI will rise toward the 1% level from FY20 appears quite optimistic. Still, the 2% price stability target cannot be achieved even in FY21. In discussing the exit strategy, the BOJ should consider flexible interpretation of the price target.

Chart: FY19-21 Forecasts of Majority of Policy Board Members (y/y % chg)

	Real GDP	CPI (less fresh food)	(Ref.) Excl. effects of consumption tax hike and policies concerning provision of free education
FY19	+0.8 ～ +0.9 [+0.8]	+0.6 ～ +0.7 [+0.6]	+0.4 ～ +0.5 [+0.4]
As of Oct	+0.6 ～ +0.7 [+0.6]	+0.6 ～ +0.8 [+0.7]	+0.4 ～ +0.6 [+0.5]
FY20	+0.8 ～ +1.1 [+0.9]	+1.0 ～ +1.1 [+1.0]	+0.9 ～ +1.0 [+0.9]
As of Oct	+0.6 ～ +0.9 [+0.7]	+0.8 ～ +1.2 [+1.1]	+0.7 ～ +1.1 [+1.0]
FY21	+1.0 ～ +1.3 [+1.1]	+1.2～+1.6 [+1.4]	
As of Oct	+0.9 ～ +1.2 [+1.0]	+1.2～+1.7 [+1.5]	

Source: BOJ; compiled by Daiwa Securities.
Notes: 1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates).
2) The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate -- namely, the figure to which he or she attaches the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors.
3) Individual Policy Board members make their forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding future policy.
4) With regard to policies concerning the provision of free education, it is assumed that measures such as free higher education will be introduced in April 2020. Taking into account the actual CPI figures for October and November 2019, the direct effects of the October 2019 consumption tax hike on the CPI for fiscal 2019 and 2020 are estimated to be 0.5 percentage point for each fiscal year. In addition, based on a specific assumption, the direct effects of policies concerning the provision of free education on the CPI for fiscal 2019 and 2020 are estimated to be around minus 0.3 percentage point and around minus 0.4 percentage point, respectively.

New descriptions indicate BOJ has not overly weakened tone of caution about risks

Regarding the risk balance, the central bank stated that "risks to economic activity are skewed to the downside, particularly regarding developments in overseas economies. Risks to prices are skewed to the downside, mainly due to the downside risks to economic activity and uncertainties over developments in medium- to long-term inflation expectations." This time around, a new description was added to downside risks concerning overseas economies—they "still seem significant, although they have decreased somewhat compared to a while ago." The judgement in the attached document for the assessment of the momentum at the October MPM was maintained—"Although there has been no further increase in the possibility that the momentum toward achieving the price stability target will be lost, it is necessary to continue to pay close attention to the possibility." This description was included in the section of the second perspective in conducting monetary policy.

As IMF also still cautious, BOJ needs to continue to pay close attention

We cannot say how long the BOJ needs to pay close attention, but the IMF also still has a cautious stance regarding the global economy. There is a good chance that recovery will be delayed to mid-2020 and beyond due to weakness in emerging economies (especially India) and various risks. At the moment, the impact of the new coronavirus also warrants attention. Regarding Japan-specific factors, the BOJ needs to gauge the impact of the consumption tax hike (recovery in Jan-Mar from plunge in Oct-Dec) and the effects of economic measures to address concerns about a post-Olympics slowdown. A wait-and-see stance is expected until at least this autumn. That said, as economic deceleration should be avoided, the BOJ is likely to continue to emphasize its assistive stance. Even if the long-term rate stays in positive territory, the BOJ is unlikely to revise the language of forward guidance immediately. I hope it will use its time effectively and deepen discussions on the next framework in line with trends at the US and European central banks.

Gov. Kuroda implied next focal points at this year's first regular press conference

Our eyes on newly established FY22 price projection in Apr *Outlook Report*

At this year's first regular press conference by BOJ governor Haruhiko Kuroda, there were two remarks that hinted at the next focal points. Frist, asked about the inconsistency on upward revisions to GDP growth projections and downward ones to price projections, he replied that "the effects that will be observed during the projection period are limited, given the time lag and sensitivity," implying that the effects may be observed after the current projection period. Regarding the question on the difficulty in achieving the price target during his term of office, he stuck with his previous opinion—"I think the CPI will steadily rise toward 2%, although I do not intend to link the achievement timing with my term of office." Meanwhile, asked if the BOJ will need to review its policy framework, he denied it, saying that "as the CPI is much lower than 2%, it is premature to change the framework or discuss it." In the next April *Outlook Report* (to be released 28 Apr), the BOJ will establish its price projection for FY22, the final fiscal year for Mr. Kuroda (term of office expires 8 Apr 2023). Our eyes are on the degree of the figure, although it may be wishful thinking.

Another focal point at Apr MPM is how "Y80tn guideline" will be treated in statement

Another remark is the reply to the question about the JGB purchase amount—"the Y80tn for annual JGB purchases is just a guideline, and the targets in policy operations are the policy interest rate and 10-year JGB yield." The Y80tn guideline may be reviewed at the start of FY20 (Apr 2020), partly due to a change in board members (Mr. Harada's term of office expires 25 Mar). Over the past two years, decisions made in April were as follows—(1) at the start of the new board in April 2018, the timing set for the price stability target was removed, and (2) forward guidance was clarified in April 2019.

Gov. Kuroda's remarks abroad also warrant attention

At the end, it was announced that Mr. Kuroda would attend the Davos meeting in Switzerland. It appears that he tends to tell more of the truth in remarks abroad. There is a possibility that his personal expectations for bright signs on overseas economies may be stronger than the BOJ's official opinion. We also intend to watch for the results of the panel discussion scheduled for 24 January.

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