Yen 4Sight

Highlights

- At its Policy Board meeting on Thursday, the BoJ will likely announce a new loan facility to support businesses impacted by the coronavirus.
- Having recently increased its asset purchases, it will also likely pledge to do more in this respect, perhaps increasing the range of private sector bonds bought and its rate of ETF purchases.
- However, while surveys point strongly to recession, it will also likely leave its interest rates unchanged.

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Interest and exchange rate forecasts

End period	13-Mar	Q220	Q320	Q420
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	-0.02	-0.05	-0.10	-0.10
JPY/USD	107	105	105	105
JPY/EUR	119	119	119	119

Source: Bloomberg, BoJ and Daiwa Capital Markets Europe Ltd.

BoJ acts to support financial markets

Against the backdrop of extreme financial market turbulence and concerns about the economic impact of the coronavirus, over the past couple of weeks the major central banks have tried to flex their monetary policy muscles. But markets have failed to be particularly impressed by the emergency rate cuts from the Fed and BoE, or the new lending support programmes from the ECB and BoE. Indeed, with liquidity strains apparent in a range of markets, the Fed announced on Thursday a substantial boost to its planned use of repurchase agreements as well as plans to conduct purchases of Treasury securities across a full range of maturities. And with JGB yields having jumped significantly and Japanese stocks having plummeted further, the BoJ finally took some action today. In particular:

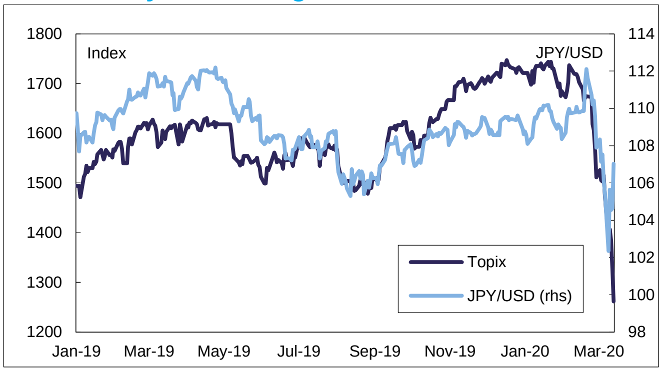
- the BoJ conducted an **unscheduled** JGB purchase operation, buying ¥200bn of 5-10Y JGBs. While this amount was smaller than most recent operations, it was within the BoJ's target purchase range for this maturity, and sought to highlight its flexible approach to its purchase programme;
- the BoJ also saw a significant increase in take up under its **Securities Lending Facility (SLF)** to ¥260bn, the most since December 2018;
- the BoJ purchased **ETFs** for the sixth time this month, and by ¥101.4bn (compared with ¥71.5bn at each operation in February). Accordingly, the BoJ has already purchased more ETFs in the first half of March than in any full month since August; and
- the BoJ offered its third "Gensaki" **JGB repurchase agreement** this month (the first since March 2016), albeit take up was just 0.1% of the ¥500bn offered.

These actions were followed by a statement indicating that the BoJ would continue with operations in this vein to ensure ample liquidity through to the end of the fiscal year.

BoJ to announce measures to support firms

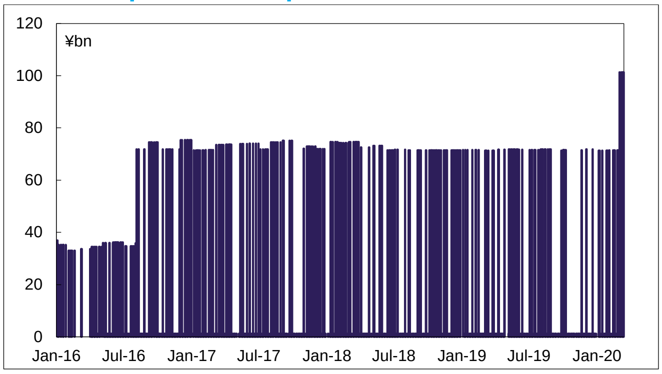
When the BoJ holds it scheduled two-day Policy Board meeting in the coming week, it will be mindful of the need to provide additional support to the economy as the coronavirus takes an increasing toll on activity. Certainly, we expect the BoJ to offer support for firms affected by the coronavirus, with a new special lending facility, akin to the funds-supplying facilities previously

TOPIX and yen exchange rate



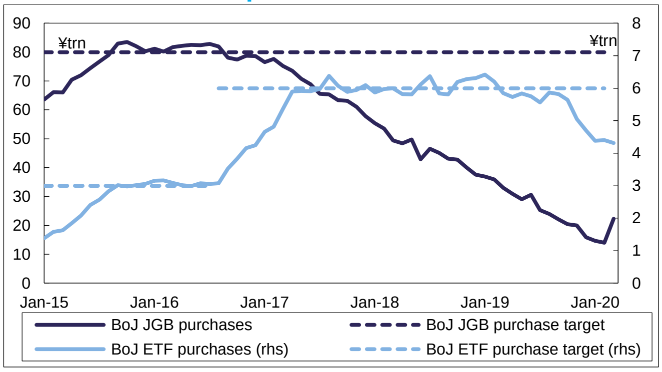
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

BoJ: ETF purchases operations



Source: BoJ, Bloomberg and Daiwa Capital Markets Europe Ltd.

BoJ: JGB and ETF purchases*



**Monthly figures on an annualised basis. Source: BoJ and Daiwa Capital Markets Europe Ltd.*

established to support financial institutions in areas affected by natural disasters. An expansion of the BoJ's purchases of private sector securities to help ease funding concerns, which could include both shorter- and longer-dated paper (the BoJ currently only buys such bonds with up to 3Y remaining maturity), might also seem appropriate. Purchases of government-guaranteed, municipal and zaito bonds for the first time also seem feasible.

BoJ steps up ETF purchases

The BoJ has already stepped up its regular ETF purchases this month. In the first half of March its holdings increased by more than ¥600bn, a rate that if sustained over the rest of the month would equate to almost one quarter of its annual purchase target of ¥6trn. But it remains to be seen whether the BoJ will explicitly increase its annual ETF target. Indeed, since last summer, the BoJ's holdings of ETFs have trended steadily below its current target (see chart). For the same reason, an explicit amendment to the annual JGB purchase target of ¥80trn seems unnecessary. Instead, the statement is likely to emphasise the BoJ's 'flexibility' incorporated in its asset buying.

Policy rate cut less likely (for now)

The marked strengthening of the yen – briefly appreciating through ¥102/$ for the first time since 2016 – had increased expectations that the Policy Board might also cut its policy rate further into negative territory next week. But with global demand for dollars are – and associated strains seemingly having become more acute – the yen has since fallen back. The decision by the ECB to keep its deposit rate unchanged and subsequent euro depreciation might also give the BoJ confidence to leave interest rates unchanged for now. Of course, if the yen heads back towards ¥100/$, we wouldn't rule out an emergency rate cut in due course, albeit with an adjustment in the tiering ratio to soften the blow to the banks.

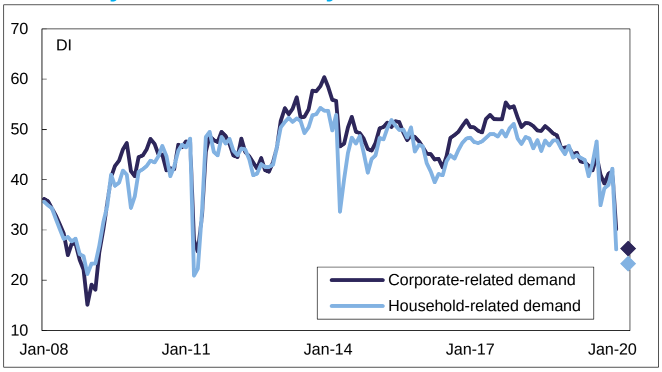
Government support package aimed at SMEs

With the economy already struggling to recover from October's consumption tax hike, and the supply- and demand-side hits from the coronavirus set to be significant and widespread, the government also approved in the past week a financial support package worth a little more than ¥1trn, offering assistance to firms and self-employed workers affected by the coronavirus. In particular, via JFC and other institutions, the government will provide low-interest loans for SMEs that have seen sales decline by 5% or more. For those suffering declines in excess of 10%, the government will pay interest on any loans taken out to compensate these losses. Firms will also be offered assistance to relocate production if required. This follows February's ¥500bn support package, providing low-interest loans to SMEs particularly in the tourism sector, taking the total support package so far to ¥1.6trn (0.3% of GDP). The government is also reportedly drafting a further emergency package for April to include cash compensation for parents forced to stop working during the extended school closure.

Economy watchers paint dire picture ahead

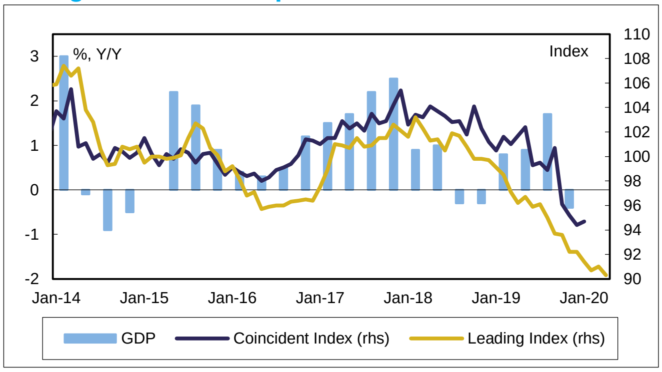
The coming week will bring the first hard data since the coronavirus outbreak escalated (February's goods trade report and overseas visitor numbers), which are likely to point to notable weakness. Certainly, surveys have already offered a

Economy watchers survey*



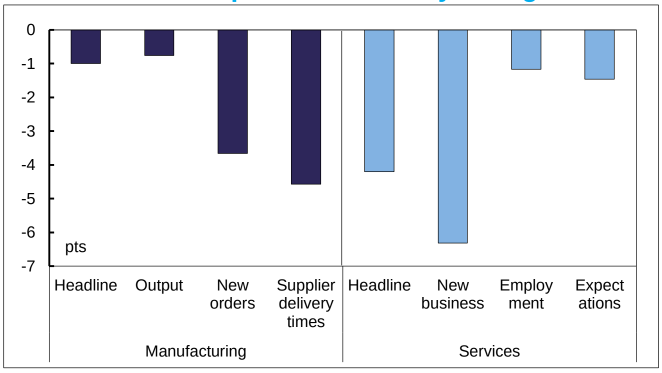
*Diamonds represent outlook three months ahead. Source: Cabinet Office, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

GDP growth and composite business indicators*



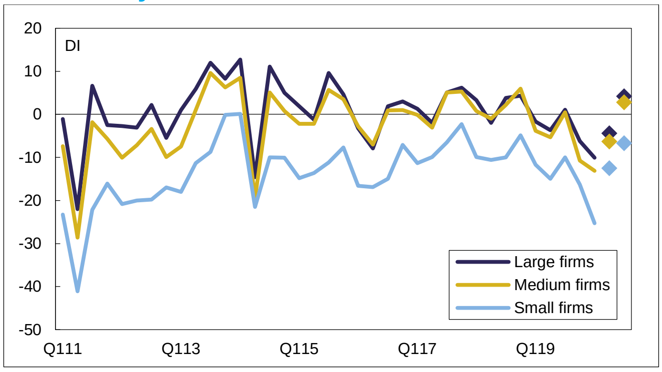
*Leading index has three-month lead. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

Selected PMI components: Monthly change*



*February 2020. Source: Markit, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

MoF survey: Business conditions*



*Diamonds represent forecasts for Q220 and Q320. Source: MoF, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

particularly dire assessment of current economic conditions. The economy watchers survey headline current conditions DI plunged 14½pts in February to 27.4, the lowest level since the 2011 Great East Japan earthquake, with a significant slump in both household- and corporate-related demand. Indeed, economy watchers noted a rapidly deteriorating situation due to the coronavirus, and an even more severe outlook – the survey's expectations component fell more than 17pts to 24.6, the lowest since the height of the Global Financial Crisis. This tallied with the Cabinet Office's leading composite indicator of business conditions, which fell to its weakest for more than decade and pointed to another quarter of negative GDP growth.

PMIs point to coronavirus disruption

February's PMIs also flagged some warnings signs. While the manufacturing index suggested only a modest drop in the output balance, new orders were notably weaker, with the 3½pt monthly drop the steepest since April 2014 to the lowest level since Abe took office in 2012. And initial supply-chain disruption was evident in the notable lengthening in suppliers' delivery times (which perversely contributes positively to the headline PMI) with the relevant index declining the most since the 2011 quake. But given the coronavirus hit to the hospitality and travel sectors, the services PMI fell a much steeper 4pts in February to the lowest level since April 2014. And the new business component slumped to its weakest since mid-2011. Overall, the composite PMI of 47.0 was consistent with the steepest pace of contraction in economic activity since the April-2014 tax hike.

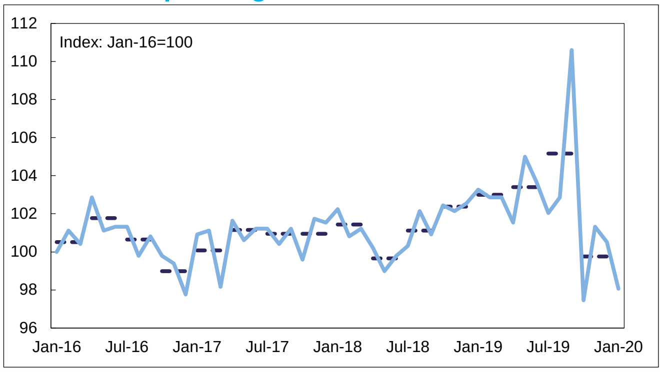
Firms remain downbeat about the outlook

The MoF's Business Outlook Survey – often a good guide to the tone of the more comprehensive and closely-watched BoJ Tankan survey (due 1 April) – was predictably downbeat about business conditions in Q1 too. Amongst large firms, a net 10.1% of respondents judged business conditions to have worsened in Q1 (a drop of almost 4ppts from Q4 when demand was whacked by October's consumption tax hike). Small- and medium-sized firms were unsurprisingly even more downbeat. While businesses were somewhat less gloomy about the outlook in Q2, on balance, they unsurprisingly remained pessimistic about the outlook ahead. And only large and medium-sized firms projected a return to a modestly positive net balance for economic conditions in Q3 – a position that seems bound to change significantly for the worse should the Tokyo Olympics in July be postponed.

Household spending weak in January

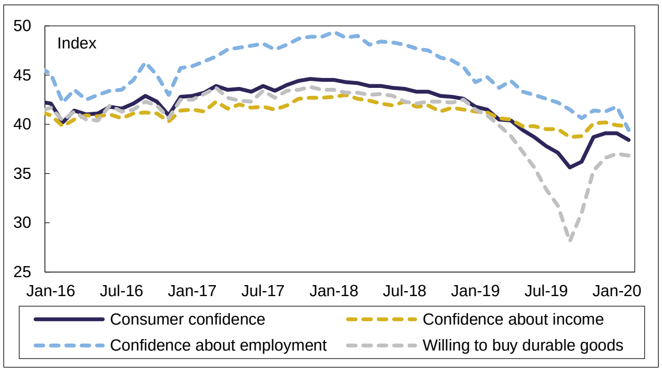
But even before the COVID-19 outbreak gained greater prominence there was no shortage of signs that domestic demand was still struggling to recover from October's tax hike. Household spending fell for the third month out of the past four in January (-1.6%M/M). And while the BoJ's consumption activity index was somewhat more encouraging, when adjusting for spending by overseas visitors, expenditure was still soft at just 0.3%M/M. There was a modest drop in expenditure on services in January (0.1%M/M). And with sporting and cultural events cancelled, major tourist attractions having temporarily closed, travel restrictions still in place and consumer confidence having been hit by the spread of the coronavirus in Japan, spending on services seems bound to fall more significantly over coming months.

Household spending*



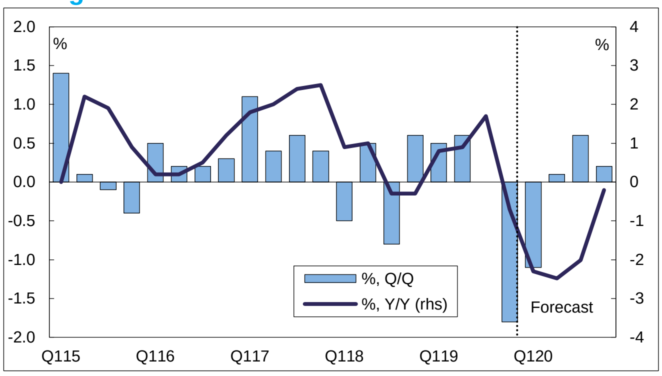
**Core expenditure. Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Consumer confidence



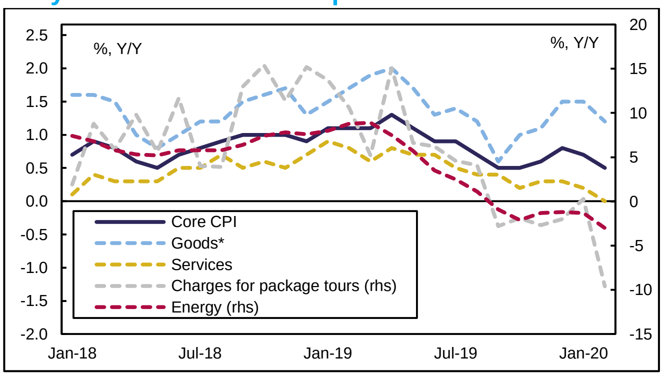
Source: Cabinet Office, Thomson Reuters and Daiwa Capital Markets Europe Ltd.

GDP growth



Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Tokyo CPI – selected components



**Excluding fresh foods. Source: MIC, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Q4 GDP revised lower

Of course, this doesn't bode well for GDP growth in Q1. Certainly, household consumption (-2.8%Q/Q) had already provided the most significant drag in Q4. And revised figures published in the past week saw private non-residential investment revised lower too, with the 4.6%Q/Q decline the largest quarterly drop since Q109. As such, headline GDP growth in Q4 was revised 0.1ppt lower to -1.8%Q/Q, only a fraction smaller than the drop seen immediately after the consumption tax hike in 2014. And with the modest growth previously estimated in Q3 completely revised away, this left the annual rate down 0.7%Y/Y. While the uncertainties surrounding the coronavirus mean that it is difficult to predict the near-term growth profile, we now expect full-year GDP growth in FY19 to be slightly negative (compared with the BoJ's January projection of 0.9%Y/Y), and return to only modest growth in FY20 (BoJ's forecast of 1.1%Y/Y).

Inflation to be much weaker too

The BoJ will also need to revise significantly lower its near-term inflation forecast. Certainly, the plunge in the oil price will see a further notable step down in energy prices. In yen terms, the oil price is almost 50% lower than its level at the start of the year, and is currently trending more than 40% lower than March last year. But February's Tokyo CPI figures had already seen a decline in energy inflation by the steepest for three years. These data similarly reported the largest annual decline in hotel charges since late-2011, related to a more than 9½%Y/Y drop in charges for package tours, as weaker demand took its toll on the tourism sector. The decision by Rakuten to offer a mobile price plan at less than half the price of its main rivals will undoubtedly weigh on inflation from April too, as will the government's extension of free education to High Schools. Taken together with weaker demand, the stronger yen, and news in the past week that workers in Japan's Rengo labour union organisation will get the smallest pay increase in seven years in 2020, we see a non-negligible possibility that headline inflation at the national level will fall back into negative territory over coming months and struggle for upwards traction thereafter.

Looking ahead…

All eyes in the week ahead will be on the conclusion of the BoJ's latest Policy Board meeting on Thursday. While we expect the BoJ to unveil measures to support lending to businesses impacted by the coronavirus, and possibly a commitment to increase its asset purchases, we don't expect any explicit adjustments to its main parameters of its yield curve control framework – i.e. the policy rate will remain at -0.1% and its 10Y JGB yield target will remain at around zero. The most noteworthy data releases will be Wednesday's goods trade report and overseas visitor numbers for February, both of which are expected to show a significant weakening. Thursday will also bring national CPI figures for February, which are expected to show that headline inflation fell to just ½%Y/Y. Monday will also bring machinery orders data for January. Meanwhile, Japanese markets are closed on Friday for the Spring Equinox national holiday.

Economic calendar

Key data releases – March/April

09	10	11	12	13
6M TB AUCTION GDP Q/Q% Q3 0.0 Q4 F -1.8 ECONOMY WATCHERS SURVEY – CURRENT CONDITIONS DI JAN 41.9 FEB 27.4 EXPECTATIONS DI JAN 41.8 FEB 24.6 BANK LENDING Y/Y% JAN 1.9 FEB 2.1 CURRENT ACCOUNT ¥TRN DEC 1.9 JAN 1.6	5Y JGB AUCTION M3 MONEY SUPPLY Y/Y% JAN 2.3 FEB 2.5		20Y JGB AUCTION BSI – ALL INDUSTRY CONDITIONS Q/Q Q4 -6.2 Q1 -10.1 GOODS PPI Y/Y% JAN 1.5 FEB 0.8	3M TB AUCTION TERTIARY ACTIVITY M/M% DEC -0.3 JAN 0.8
16	**17**	**18**	**19**	**20**
LIQUIDITY ENHANCING AUCTION (APPROX ¥0.6TRN) MACHINE ORDERS M/M% DEC -12.5 JAN -1.0	1Y TB AUCTION (APPROX ¥1.9TRN) INDUSTRIAL PRODUCTION M/M% DEC 1.2 JAN F 0.8	3M TB AUCTION (APPROX ¥4.74TRN) GOODS TRADE BALANCE ¥BN JAN -224 FEB 544 OVERSEAS VISITORS MN JAN 2.66 FEB N/A BOJ FLOW OF FUNDS (Q4) BOJ POLICY BOARD MEETING (18-19 MARCH 2020)	NATIONAL CPI JAN 0.7 FEB 0.5 ALL INDUSTRY ACTIVITY M/M% DEC 0.0 JAN 0.5 BOJ POLICY BOARD ANNOUNCEMENT	NATIONAL HOLIDAY – VERNAL EQUINOX
23	**24**	**25**	**26**	**27**
	ENHANCING LIQUIDITY AUCTION MANUFACTURING PMI (MAR P) SERVICES (MAR P) COMPOSITE (MAR P) NATIONWIDE DEPARTMENT SALES (FEB)		40Y JGB AUCTION SERVICES PPI (FEB)	3M TB AUCTION TOKYO CPI (MAR)
30	**31**	**01**	**02**	**03**
BOJ SUMMARY OF OPINIONS (18-19 MARCH MEETING)	2Y JGB AUCTION INDUSTRIAL PRODUCTION (FEB) RETAIL SALES (FEB) UNEMPLOYMENT RATE (FEB) JOB-TO-APPLICANT RATIO (FEB) HOUSING STARTS (FEB) CONSTRUCTION ORDERS (FEB)	BOJ TANKAN (Q1) MANUFACTURING PMI (MAR F) VEHICLE SALES (MAR)	BOJ TANKAN – INFLATION OUTLOOK OF ENTERPRISES (Q4) MONETARY BASE (MAR)	SERVICES PMI (MAR F) COMPOSITE PMI (MAR F) BOJ ESTIMATE OF OUTPUT GAP AND POTENTIAL GROWTH (Q4)

**Approximate date of release. Source: BoJ, MoF, Bloomberg, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

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