Daiwa Securities

Daiwa's View

Roles of gov't and BOJ in Gov. Kuroda's remarks

- *Outlook Report* amid COVID-19 pandemic, next important point is examination in Oct

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Jul BOJ MPM uneventful, as expected

The BOJ's Monetary Policy Meeting (MPM) on 14-15 July was uneventful as expected because (1) only a month has passed since its June policy meeting, (2) not enough new data has been collected on the economy after its reopening, and (3) financial markets have stabilized thanks to the effects of various measures by governments and central banks in each country.

Jul *Outlook Report* back to median forecasts, largely in line with prior projections

Will preconditions be met? BOJ projections should be seen as best-case scenario

In the July *Outlook for Economic Activity and Prices* report (*Outlook Report*), the method to compile "Forecasts of the Majority of the Policy Board Members" has returned to the using medians from a "forecast range" (excl. two highest and two lowest figures) as of April. Therefore, simple comparison is impossible, but the scenario of a gradual recovery in 2H 2020 is unchanged. The BOJ also opines that the latest forecasts are largely in line with the previous ones. However, it set three major preconditions: (1) a second wave of COVID-19 will not occur on a large scale, (2) medium/long-term growth expectations at firms and households will not decline substantially, and (3) financial system stability should be maintained. Currently, we are seeing a resurgence of COVID-19 cases, which will likely force the BOJ to review the first precondition. Regarding the second, a decline in growth expectations would be unavoidable in some sectors under the new normal of COVID-19. As for the third, stability should be maintained by all means via cooperative preventive measures by the BOJ and the government. Obviously, the downside risk is large. We had better regard the BOJ forecasts as the best-case scenario.

BOJ's forecasts for FY20 growth rate optimistic vs. private-sector forecast, while price forecast close

Central banks around world need more discussion on price objective

The BOJ's median forecast for the FY20 growth rate is optimistic vs. the private-sector forecast of −5.44% (avg. of ESP forecast survey in Jul), while, the price forecast is close to the private-sector figure of −0.51%. The BOJ projects that the economy will return to normal by FY22 and the growth rate will exceed the potential growth rate for two years in a row, but this includes wishful thinking. FY22 is the final year for Gov. Kuroda (term of office expires 8 Apr 2023), but the CPI growth rate is expected to be at +0.7%, far below the 2% target. Amid the crisis response mode, there is no need to stick with the 2% target ("2%" removed from descriptions of "first perspective" in *Outlook Report*). However, these projections are equal to the BOJ's announcement that prices will not rise even under the best economic recovery. Amid the COVID-19 new normal, central banks around the world probably need more discussion on the price objective, although Gov. Kuroda denied it at a post-MPM press conference, saying that "there is no need to do so at all."

Jul Kuroda press conference had two points of focus

One is introduction of positive note of economic assessment

At the beginning of the regular post-meeting press conference in July, Mr. Kuroda said that measures to cope with the COVID-19 pandemic since March "have been showing an effect," replying to the question from a round-robin media company of the BOJ Club. He called the measures the "three pillars." This time, there are two points of focus. One is the assessment on the current economic condition. He introduced a positive note, saying that "I think that consumption and the production of goods have bottomed out."

In fact, the expression "recent signs of a pick-up" was added to the private consumption section in the July assessment to the economic condition.

Other not financing but solvency issue

Exit of crisis response measures still far off

The other is the fact that he pointed out that some companies may face a solvency issue, not a financing issue, when asked about the case of prolonged impacts from the pandemic. However, he explained the difference in roles—"I think that the issue should be solved by the government and the business sector surrounding such firms, and solving that issue is not the role of the central bank." Nevertheless, he recognized the severity of the current situation, saying that "we need to continue with financing support programs for quite a long time." The end to the crisis response measures is still far off. Operations to provide dollar funds are also the case. Whether the BOJ will extend the period of the special program set till end-March 2021will be decided by end-September 2020, six months before the current deadline.

Due to effects of YCC, policy mix of monetary, fiscal policies automatically realized

Other than these points, what is important is the explanation about the BOJ's intention to continue with flexible policy operations under the current framework in the near term. We should remember his statement—"In the case of increased JGB issuance by the government in line with its needs, the resultant rise in yields can be avoided under the yield curve control. In short, the policy mix of monetary and fiscal policies is automatically realized."

Outlook remains very uncertain

Next point of focus is Oct *Outlook Report*

All in all, the outlook remains very uncertain, despite some positive signs for recent economic indicators. In the phase of crisis responses, the government plays a large role in the support of continued business operations, maintenance of employment, and prevention of chain-reaction bankruptcies. The top priority at the BOJ is to stabilize the financial system. To cope with increased JGB issuance in line with the government's fiscal spending, the BOJ is likely to continue to provide support in the near term by buying the necessary amount of JGBs to rein in the rise in the 10-year JGB yield (around 0%). The central bank would deem that additional easing will be necessary only in the case of major downward revisions to the economic outlook and/or appreciation of the USD/JPY rate staying below Y100. It will continue to monitor the rate of COVID-19 infections. The next important point of focus is the October *Outlook Report.*

Chart: FY20-22 Forecasts of Majority of Policy Board Members (y/y % chg)

	Real GDP	CPI (all items less fresh food)	(Ref.) Exc. effects of consumption tax hike and policies concerning provision of free education
FY20	−5.7 ～ −4.5	−0.6 ～ −0.4	−0.7 ～ −0.5
	[−4.7]	[−0.5]	[−0.6]
As of Apr 2020	−5.0 ～ −3.0	−0.7 ～ −0.3	−0.8 ～ −0.4
FY21	+3.0 ～ +4.0	+0.2～+0.5	
	[+3.3]	[+0.3]	
As of Apr 2020	+2.8 ～ +3.9	0.0～+0.7	
FY22	+1.3 ～ +1.6	+0.5～+0.8	
	[+1.5]	[+0.7]	
As of Apr 2020	+0.8 ～ +1.6	+0.4～+1.0	

Source: BOJ; compiled by Daiwa Securities.

Notes: (1). Figures in brackets indicate medians of Policy Board members' forecasts (point estimates).

(2) Forecasts of majority of Policy Board members constructed as follows: each Policy Board member's forecast takes form of point estimate—namely, figure to which they attach highest probability of realization. These forecasts then shown as range, with highest and lowest figures excluded. Range does not indicate forecast errors.

(3). In Apr Outlook Report, each Policy Board member made forecasts as range and submitted two figures (i.e., highest and lowest figures) within range of 1.0 percentage point at most. Forecasts of majority of Policy Board members shown as range excl. four figures—namely, two highest and two lowest figures among forecasts of nine members. It should be noted that definition of forecasts of majority of Policy Board members in Apr Outlook Report differs from that in Jul Outlook Report.

(4) Each Policy Board member makes forecasts taking into account the effects of past policy decisions and with reference to views incorporated in financial markets regarding future conduct of policy.

(5) The direct effects of the Oct 2019 consumption tax hike on the CPI for fiscal 2020 estimated to be 0.5 percentage points. In addition, based on specific assumption, direct effects of policies concerning provision of free education on CPI for fiscal 2020 estimated to be around minus 0.4 percentage points.

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[Standard & Poor's]

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