Daiwa Securities

Daiwa's View

Final decision at BOJ's Mar meeting to be made on 19th

- Technical means expected, given background of assessment and awareness of issue

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Daiwa Securities Co. Ltd.

Final decision at BOJ's Mar meeting to be made on 19th

Final decision at Mar MPM to be made on 19th

Quantitative easing policy introduced 19 Mar 2001, 20 years ago; BOJ crossed Rubicon many times, but rise in prices yet to gain momentum

The BOJ is to finally announce the results of the policy assessment at the Monetary Policy Meeting (MPM) at the end of this week. The final decision is to be made on Friday, 19 March. In fact, 19 March 2001, 20 years ago, falls on the day when the BOJ introduced the quantitative easing policy led by then governor Masaru Hayami (operational target shifted from interest rates to money supply). At that time, I was in Sakura Bank's dealing room and wrote in my report that the BOJ had finally "crossed the Rubicon" due to the failure in removing zero interest rates (decided on 11 Aug 2000). Since then as well, the BOJ has had a history of struggling to fight deflation and crossed the Rubicon many times via the introduction of the asset purchase fund (purchases of ETF/corporate bonds) and the price stability target by then governor Masaaki Shirakawa, as well as the introduction of drastic easing, negative interest rates, and the yield curve control (YCC) policy by current governor Haruhiko Kuroda. However, the rise in prices has not yet gained momentum partly due to the COVID-19 pandemic. The background of this assessment is sluggish prices, and the awareness of the issue lies in the difficulty in ensuring the sustainability of easing, while constraining the side effects, on the premise of prolongation of the easing. As a result, it seems that the BOJ thought it necessary to find more ways in terms of operations.

Key phrases of assessment are "nimble" and "in a prioritized manner"

Preparation for possible changes in economic activity and prices as well as financial conditions

At the MPM on 18 December 2020, the BOJ announced that it would assess easing measures in March. At the press conference, Gov. Kuroda made a definitive statement that "we will not review the 2% target, inflation-overshooting commitment, or negative rate policy," saying that "we will examine operations under YCC and various measures such as asset purchases." As the framework is not reviewed, this is not "consideration" but "assessment." From the initial stage, the BOJ's announcement of only the technical means was a done deal. The BOJ started to use the key word "nimble" of this assessment in a quite early stage. The phrase was first used in Gov. Kuroda's speech on 24 December 2020. Also in the Summary of Opinions at MPM on 17-18 Dec 2020, a member said that "it is necessary to be prepared so that it can respond effectively to possible changes in economic activity and prices as well as financial conditions," giving us the impression that operational devices could be advance preparation in the case of a change in economic conditions (upward/downward fluctuations). These expressions are likely to be included in the statement. Also, we found that the target of advance preparation included both YCC and purchases of assets (such as ETFs) at the time of this meeting. In the Summary of Opinions at the January MPM, members said that it was important to act not only "nimbly" but also "flexibly in a prioritized manner."

◆ **Speech by BOJ Gov. Haruhiko Kuroda** (24 Dec 2020)

- As evidenced by the sudden occurrence of COVID-19, various shocks may happen in the future. Thus, it is necessary to be nimble in making effective responses when needed to counter possible changes in economic activity and prices, as well as financial conditions.

◆ **Summary of Opinions at MPM on 17-18 Dec 2020**

- It is necessary for the Bank to enhance sustainability of yield curve control and purchases of assets, such as ETFs, through flexible conduct and be prepared so that it can respond effectively to possible changes in economic activity and prices as well as financial conditions.

Source: Extracted from BOJ materials.
Note: Bold, color, underline added by author.

Operations in prioritized manner mean increase/ decrease in purchases due to fluctuations of yield/stock prices caused by change in economic conditions

In terms of flexible operations in a prioritized manner, the BOJ will implement yield curve control so as to allow rates to rise if the economy improves while accepting a decline in rates if the economy deteriorates. We expect it to balance its ETF purchases, reducing them when share prices are rising to reflect economic improvement and increasing them when share prices are declining to reflect risk-off moves and the economy's weakening. The language in its latest written statement (see below) already allows for long-term rates to fluctuate in accordance with prices and economic conditions and for it to raise or lower its ETF purchases (footnote) in accordance with market conditions. How the BOJ rewrites this language should put its wisdom to the test.

◆ **BOJ Statement**

(1) Yield curve control

The long-term interest rate:

The Bank will purchase a necessary amount of Japanese government bonds (JGBs) without setting an upper limit so that 10-year JGB yields will remain at around zero percent. While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices[1].

(2) Guidelines for asset purchases:

The Bank will actively purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) for the time being so that their amounts outstanding will increase at annual paces with the upper limit of about 12 trillion yen and about 180 billion yen, respectively[2].

Rapid changes in global interest rate environment caused BOJ to rethink initial plan to widen allowable trading band for long-term yield

Since the announcement on the March assessment meeting, we have seen various speculative articles. During this period, the global interest rate environment has drastically changed. As the market and economy are alive, the subsequent rise in yields forced the BOJ to revise its thoughts at that time when the 10-year JGB yield was relatively stable at around 0.02%. Around the time when Jiji Press reported on 15 January that the BOJ would consider widening the trading band for the 10-year JGB yield, the 10-year US yield rose to 1.2% at one point due to the "blue wave" and expectations for an economic package. Meanwhile, the 10-year JGB yield changed little, which raised concerns about a decline in market functions. There are clear differences between now and then in terms of both economic conditions and progress administering vaccines in Japan and the US.

Concerns about decline in market functions eliminated by rise in yields in Feb

Yields fell sharply due to Gov. Kuroda's remark on 5 Mar; Excessive moves cooled by implying stance of accepting fluctuations within certain range

On 26 February, the 10-year JGB yield rose to 0.175% at one point in line with US yields. It was within "about double the range of around plus or minus 0.1%," but the BOJ probably felt the need to communicate with the market. Then, Deputy Gov. Masayoshi Amamiya's appearance at the dais on 8 March (online speech at Yomiuri Economics Forum) appears to have been decided as the policy assessment is led by him. Before this speech, Gov. Kuroda, responding to a question on 5 March at the Diet about the 10-year JGB yield trading band, stated that he saw no need to widen it. He clearly ruled out such widening, implying that the BOJ would check any further rise in yields. This surprised the market, which had been assuming that a widening of that band was already a done deal, partly because the tone of the governor's remark was strong. The 10-year yield fell sharply below 0.10% at one point. To cool down this condition a little bit, on 8 March Mr. Amamiya appears to have used the phrase "within a certain range" and noted that the BOJ can find more ways.

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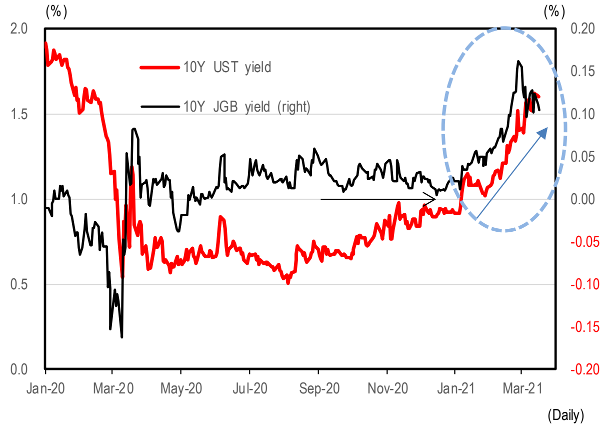
[1] In case of rapid increase in yields, Bank will purchase JGBs promptly and appropriately.

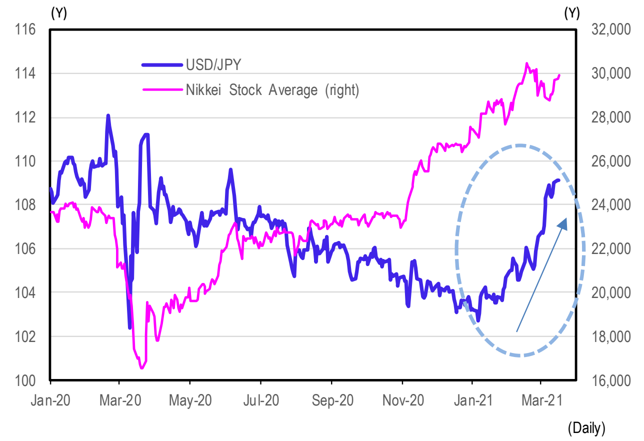
[2] As for guideline for purchases of ETFs and J-REITs, in principle, "the Bank will purchase these assets so that their amounts outstanding will increase at annual paces of about Y6tn and about Y90bn, respectively. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions."

Long-term Yield Trends in Japan and US (from 2020)



Source: Bloomberg; compiled by Daiwa Securities.

Nikkei Stock Average, USD/JPY (from 2020)



Source: Bloomberg; compiled by Daiwa Securities.

Recognition as of Jul 2018, Sep 2016 unchanged

Also keeping in mind that entire yield curve should be stable at low level

Mr. Amamiya also said that the BOJ needed to keep three points in mind in controlling the yield curve—(1) there is no change in its stance that "interest rates might move upward and downward to some extent, mainly depending on developments in economic activity and prices," which was clarified at the July 2018 MPM, (2) there is no change in the recognition that "an excessive decline in superlong interest rates could have an impact of lowering the rates of return on insurance and pension products" at the time of Comprehensive Assessment in September 2016, either, and (3) while the economy has been damaged by the COVID-19 pandemic, what is important now is to maintain stability in the bond market and stabilize the entire yield curve at a low level. I think that these three points will be mentioned in the explanatory text of the assessment.

ETF purchases to be revised to flexible ops in prioritized manner after analyzing differences in effect depending on conditions

Next, Mr. Amamiya gave two examples of "nimble and effective" responses: (1) cutting short- and long-term interest rates, and (2) purchasing ETFs and J-REITs. Regarding the second, he noted that "decisive purchases have had significant positive effects in terms of easing market sentiment, which had deteriorated considerably." This lays out a path for flexible purchases in a prioritized manner after analyzing differences in effect depending on prevailing conditions. As mentioned above, the statement is expected to be revised and to include easy-to-understand expressions for "flexible operations in a prioritized manner." Therefore, we will note how the BOJ will deal with figures (whether figure of Y6tn in principle will be removed). That said, it would be meaningless for the BOJ to disrupt markets by acting right before the fiscal year-end.

Via assessment, BOJ aims to eliminate view that monetary policy deadlocked

Emphasizing cut in short/long-term rates, BOJ trying to make it more feasible by offering measures to cope with side effects

How much will three-tier structure of current accounts be revised led by practical staff?

Regarding the first, he noted that "cutting short- and long-term interest rates is one of the essential options for additional easing measures." After the BOJ announced its policy review, the media was already speculating that one option for the BOJ to deal with the next crisis would be to further deepen negative interest rates, but this is the first time that the BOJ has stated that so clearly in a formal written document. Pushing back against the market view that cutting short- and long-term rates would be difficult, he seems to have intended to clarify that there is a way to make financial conditions more accommodative if needed. At the assessment meeting, the BOJ aims to eliminate the recognition that monetary policy is deadlocked. Instead of merely emphasizing the option, the central bank is trying to make it more feasible and convincing by considering the impact on financial intermediation functions and thinking of measures to cope with the side effects (revision to three-tier structure of current accounts). The related analysis materials appear to have been prepared already. Neither the Summary of Opinions nor major speeches have touched on the revision to the three-tier structure. Our impression is that board members have so far lacked enthusiasm for doing so and the revision is being led by practical staff. It is thus difficult to forecast how much the structure will be revised. A key would be whether the issue will win assent from board members.

Many new expressions to appear in statement of Mar assessment meeting

Appendix materials to be released; Looking for smooth communication

Based on the above, we think it likely that in its March policy review the BOJ will consider the three options outlined by Deputy Gov. Amamiya—(1) allowing for fluctuations in interest rates within a certain range (figures clearly written?), (2) showing the option of cutting short- and long-term rates as an additional easing measure (at same time, will three-tier structure be revised?), and (3) reviewing its ETF and J-REIT purchase operations to ensure more flexibility in a prioritized manner. The statement is expected to be rewritten, with the inclusion of many new expressions. We should prepare for the case that many appendix materials will be announced on the day of the assessment. Hopefully the BOJ will make an effort to smoothly communicate with the market by summarizing key points in one sheet.

◆ **Speech by Deputy Governor Masayoshi Amamiya** (8 Mar 2021)

- In conducting yield curve control in a sustainable manner, it is important **to strike an appropriate balance between maintaining market functioning and controlling interest rates**. The Bank believes that **it can find more ways to achieve this balance** because, although significant fluctuations in interest rates could lead to undesirable consequences, fluctuations within a certain range could have positive effects on the functioning of JGB markets without losing the effects of monetary easing.

<Nimble and effective responses>

- Cutting short- and long-term interest rates is one of the essential options for additional easing measures.
- A further decline in interest rates could affect the functioning of financial intermediation. In addition, it is true that because of this possible negative impact, o**ne view in the market is that the Bank finds it difficult to further cut short- and long-term interest rates**. With these factors in mind, **it is appropriate to ensure that the Bank can cut them with consideration for the impact on the functioning of financial intermediation.**

Source: Extracted from BOJ materials.
Note: Bold, color, underline added by author.

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[Standard & Poor's]

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[Moody's]

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[Fitch]

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