

# Daiwa's View

FICC Research Dept

## BOJ Dec meeting was totally non-committal regarding normalization

- Forward guidance was maintained in statement
- No signal indicating elimination of negative interest rates at subsequent meetings
- Providing messaging while aware of the forward guidance trap

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Yesterday's December Monetary Policy Meeting (MPM) was an important opportunity to get a feel for the BOJ's stance regarding the extent of rate hikes after elimination of negative interest rates. However, no clear signal was confirmed in messaging from the BOJ, including the Governor's press conference.

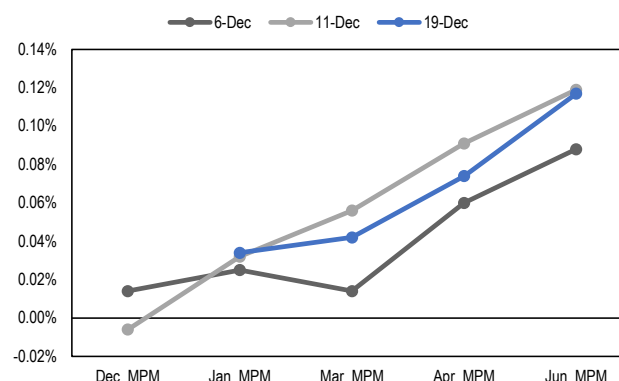
With some market participants viewing the messaging as dovish, JGB yields were on a downtrend. The USD/JPY rate reacted in the direction of yen depreciation. Confirming how the market is pricing in policy interest rates, we found that the 3-month JPY OIS rate has changed little. Looking at the levels of the forward OIS rate at MPM meetings when the market expects negative interest rates to be eliminated from January 2024 onwards, while levels at the March and April meetings have declined slightly, levels at the January and June meetings have not changed.

The market's expectations for elimination of negative interest rates have been maintained, despite the fact that the BOJ has not sent a clear message. In this respect, the BOJ can be said to have maintained a successful dialogue with the market while maintaining flexibility with regard to future policy operations.

This method of communication implements the strategy for avoiding the forward guidance trap advocated by Professor Athanasios Orphanides. This strategy was touched on by BOJ Deputy Governor Ryozyo Himino at his press conference on 6 December.

**3-month JPY OIS Rate**

Source: Bloomberg; compiled by Daiwa.

**Changes in Forward OIS Rate at Each MPM Meeting**

Source: Bloomberg; compiled by Daiwa.

**Press conference by BOJ Deputy Governor Ryozi Himino (6 Dec 2023)**

As we move forward with monetary easing, we feel it would be very risky to decide in advance what the concrete sequence of events would be going forward. Based on information such as the remarks by Professor Orphanides at an international conference, we have learned that making mistakes with regard to the timing of an exit strategy causes issues. In our forward guidance, we have indicated that we would continue monetary easing until the price stability target was achieved in a sustainable and stable manner. We believe it would be best to make the appropriate determinations with regard to how to respond specifically once these conditions have actually been met.

The BOJ's Institute for Monetary and Economic Studies (IMES) held the 2023 BOJ-IMES Conference on 31 May and 1 June. This, the first in-person conference in four years, had the theme "Old and New Challenges for Monetary Policy," and saw discussion regarding the issues and outlook for monetary policy. One of the keynote speakers at the conference was Professor Orphanides.

In his speech, Professor Orphanides stated that the Fed and the ECB have ended up falling into a "forward guidance trap" because of delayed responses to higher inflation. He also argued that using the central bank's policy reaction function can avoid the forward guidance trap and improve policy outcomes through clearer communication.

He showed that the rapid economic recovery from the pandemic exceeded the expectations of the Fed and the ECB, and that central banks were too slow to adjust their policies and ended up falling behind the curve. Specifically, he noted, for the Fed, that some elements, including the change to outcomes-based forward guidance and the sequence of asset purchasing and policy rate hikes, have delayed the policy response to inflation. He pointed out that forward guidance provides useful information about the policy rate path only when the economic situation remains in line with the baseline outlook; in the event of an unexpected increase in inflation, forward guidance could create traps that prevent a rapid policy response.

Considering messaging by the BOJ in light of these points, the fact that the central bank did not send a clear signal at the December meeting may suggest that, in a sense, it began to steer towards a situation in which it can conduct rapid policy reactions to higher inflation, including avoiding falling behind the curve.

We need to continue to pay attention to trends with the BOJ as it heads towards elimination of negative interest rates. The BOJ appears to have obtained a free hand with these latest communications. Similar to recent FOMC meetings, messaging at BOJ meetings is likely to go "live."

We now think that BOJ officials are unlikely to touch on the extent of rate hikes in advance, which is the focus of attention in the market. As Governor Ueda stated at his press conference, the decisions will likely be made at each meeting. In that sense, we have no choice but to project the extent of rate hikes in the future based on reaction functions that are currently presented. The market is expected to have greater interest in fundamentals than before.

**Press conference by BOJ Governor Kazuo Ueda (19 Dec 2023)**

Policy changes and policy revisions are decided on through discussion at each MPM. Revisions or changes could be made if new information comes in. As new information tends to be things that were not expected at the previous meeting, surprises are not entirely avoidable. However, in so far as possible, we are always trying to carefully explain our basic thinking regarding how new information is used for policy decisions. So, we think it is predictable to some degree.

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