All Signal, No Noise

MARKET ANALYSIS

MNI Review – July 2020

Meeting Date: Tuesday July 14 – Wednesday July 15 2020

Link To Statement: https://www.BoJ.or.jp/en/announcements/release_2020/k200715a.pdf

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Central Bank Watch - Bank of Japan

MNI Bank of Japan Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Tokyo CPI	% y/y	0.3	0.4	↓	1.0	↓					-1.23
Tokyo CPI - Ex Fresh Food	% y/y	0.2	0.4	↓	0.8	↓					-0.71
PPI	% y/y	-1.6	-0.5	↓	0.9	↓					-0.68
Inflation Swap 5y5y	%	-0.20	-0.23	↑	0.15	↓					-0.70
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Industrial Production	% m/m	-8.9	-0.3	↓	-0.6	↓					-2.59
Tertiary Industry Index	% m/m	-2.1	-0.7	↓	1.0	↓					0.07
Core Machinery Oders	% m/m	1.7	2.3	↓	11.9	↓					0.35
Exports	% y/y	-28.3	-1.0	↓	-7.9	↓					-1.82
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M2 Money Supply	% y/y	7.2	3.2	↑	2.7	↑					3.91
Bank Lending	% y/y	6.2	2.0	↑	1.8	↑					1.97
Loans Outstanding (Bus)	% y/y	8.31	2.36	↑	2.02	↑					2.20
Housing Starts	% y/y	-12.3	-12.3	→	-12.7	↑					-0.78
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	-12.3	1.6	↓	-2.1	↓					-2.40
Household Spending	% y/y	-16.2	-0.3	↓	-2.0	↓					-1.95
Unemployment Rate	%	2.9	2.4	↑	2.2	↑					1.98
Ave Monthly Cash Earnings	% y/y	-2.1	0.7	↓	0.1	↓					-2.07
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Nikkei 225	Index	22288	18917	↑	23657	↓					0.40
Japanese 10-Year Yield	%	0.03	0.02	↑	-0.01	↑					1.03
Japan Yield Curve (2s-10s)	bps	15.9	15.7	↑	12.0	↑					1.01
JPY TWI	Index	117.00	119.01	↓	115.59	↑					-0.32

Source: MNI, Bloomberg

MNI POV (Point Of View): No Change, Caution Remains

This decision held nothing in the way of surprises, with the Bank leaving its monetary policy settings unchanged, matching universal expectations and falling in line with guidance from the Bank ahead of time.

The Bank also re-affirmed its official forward guidance, noting that:

“For the time being, the Bank will closely monitor the impact of the novel coronavirus (COVID19) and will not hesitate to take additional easing measures if necessary, and also it expects short- and long-term policy interest rates to remain at their present or lower levels.”

In terms of the voting breakdown, newcomer Nakamura voted in line with the majority, as expected, while serial dissenter/reflationist Kataoka took two familiar lines of dissent, as was widely expected:

“Mr. Kataoka dissented, considering that it was desirable to further strengthen monetary easing by lowering shortand long-term interest rates, in response to a possible increase in downward pressure on prices and with the aim of alleviating firms' and households' interest burden.

Mr. Kataoka dissented, considering that, given the severe impact of COVID-19, further coordination of fiscal and monetary policy was necessary and it was appropriate for the Bank to revise the forward guidance for the policy rates to relate it to the price stability target.”

In terms of the economic outlook, the Bank noted that “Japan's economy has been in an extremely severe situation with the impact of COVID-19 remaining at home and abroad, although economic activity has resumed gradually.”

The forecast for FY2020 GDP growth was in the lower end of the range of estimates provided back in April (with the range shifted lower), as expected, with little to note across the broader suite of economic projections.

All in all, nothing really changed this time out, with the Bank still ready to act again, if required. Ultimately, BoJ policy has been operating in close proximity to its limits for several years, unable to fire up inflationary pressure. COVID-19 presents the latest challenge for the Bank to deal with. Still, Governor Kuroda once again noted that he sees no value in lowering/altering the BoJ’s inflation goal.

MNI REVIEW: BoJ Policy Unchanged; Maintains Forward Guidance

--BoJ won't hesitate to take additional easing measures if needed
--BoJ voted 8-1 to keep policy unchanged

By Hiroshi Inoue

TOKYO (MNI) - The Bank of Japan left monetary policy unchanged Wednesday, taking time to assess the impact of its lending facility on the pandemic-hit economy, although stressing it remains ready to take further action if needed.

Policymakers also left the forward guidance for policy rates, indicating a continued vigilance against the impact of prolonged coronavirus on economy and financial markets, although the BoJ still expects a recovery through the second half of the year.

"For the time being, the BoJ will closely monitor the impact of Covid-19 and will not hesitate take additional easing measures if necessary, and also it expects short- and long-term interest rates to remain at their present or lower levels."

--POLICY ACTIONS

On the monetary policy, the board decided voted 8-1 to stand pat on the yield curve control policy and asset purchases, maintaining its recovery scenario helped by pent-up demand, accommodative financial conditions, and the government's economic stimulus. Under the framework, adopted in September 2016, the BoJ will keep overnight rate target at -0.1%.

The BoJ will continue buying JGBs as needed to stabilize the 10-year yield "around zero percent", but it will also allow the long-term yields to "move upward and downward to some extend mainly depending on developments in economic activity and prices."

The BoJ also left the scale of its purchases of ETFs (exchange-traded funds) and J-REITs (Japan real estate investment trusts) unchanged at about JPY12 trillion and about JPY180 billion, respectively.

--DISSENT

Goushi Kataoka, a former private-sector economist, dissented, considering that it was desirable to strengthen monetary easing by lowering both short- and long-term interest rates, in response to a possible increase in downward pressure on prices and with the aim of alleviating firms' and households' interest burden.

He also dissented on the forward guidance, saying, further coordination of fiscal and monetary policy was necessary, judging from Covid-19's impact, adding it was appropriate for the BoJ to revise the forward guidance for the policy rates tying it to the price stability target.

MNI POLICY: BoJ Cuts GDP Outlook; Infl'n View Little Unchanged

By Hiroshi Inoue

TOKYO (MNI) - The Bank of Japan lowered its growth forecast for the fiscal year to March 31 2021, citing weaker overseas economies, hit by Covid-19, weighing on Japan's exports and production, the quarterly outlook report released Wednesday showed.

Inflation forecasts were left broadly unchanged from those three months ago.

The BoJ published median forecast for growth and inflation, having published only a range of expectations in the April report, noting "risks to both economic activity and prices are skewed to the downside, mainly due to the impact of Covid-19."

The BoJ continues to see a pick-up in coming months, saying, "the economy is likely to improve gradually from the second half of this year with economic activity resuming, but the pace is expected to be only moderate while the impact of the Covid-19 remains worldwide."

--GDP AND CPI

The median forecast for gross domestic product in this fiscal year was -4.7%, compared with a range of -5.0% to -3.0% made in April. For 2021 and 2022, the outlook was +3.3% and +1.5%, compared with a range of +2.8% to +3.9% and a range of +0.8% to +1.6% in April, respectively.

Despite the downward revision to the GDP forecast, inflation forecasts were large unchanged from three months ago.

The median forecast for core inflation rate in this fiscal year was -0.5%, compared with a range of -0.7% to -0.3% in April, then in fiscal 2021 and 2022, +0.3% and +0.7% vs. a range of 0.0% to 0.7% and a range of +0.4% to +1.0% in April.

--ECONOMY

The outlook is extremely unclear, since it could change depending on the consequence of Covid-19 and the magnitude of their impact of domestic and overseas economies, the report noted.

It is based mainly on the assumptions that a second wave of Covid-19 will not occur on a large scale and that, while the virus remains, firms' and households' medium- to long-term growth expectations will not decline substantially and the smooth functioning of financial intermediations will be ensured with financial system stability maintained.

--INFLATION EXPECTATIONS

Inflation expectations have weakened recently, with the BoJ warning "it is expected that prices of goods and services that are sensitive to economic activity will be pushed down."

"Medium- to long-term inflation expectations are likely to continue weakening somewhat," the report said.

The BoJ also warned, "If such expectations decline due to the shock caused by Covid-19 that pushes down the economy considerably there is a risk that firms' and households' appetite for spending will not increase easily even after Covid-19 subsides."

Although not high, there is a risk that the vulnerability of the financial system could increase.

"When examining financial imbalances form a longer-term perspective, prolonged downward pressure on financial institutions' profits could create a risk of a gradual pullback in financial intermediation," the outlook report said.

MNI POLICY: BoJ Kuroda: Policy Take Effect; Will Act If Needed

By Hiroshi Inoue

TOKYO (MNI) - Measures taken by the Bank of Japan and the government since March to facilitate corporate financing and to maintain the stability of financial markets are taking effect, Governor Haruhiko Kuroda told reporters Wednesday, adding that the central bank would not hesitate to take further action if needed.

"The BoJ continues to implement the measures steadily and support corporate financing," Kuroda told reporters.

"(We) will not hesitate to take additional easy measures if needed," he added.

As for possible options, Kuroda said expanding the scale of program and lowering short- and long-term policy rates were future policy options

"But what kind of measures the BoJ may take depends on economic and financial conditions at that time," Kuroda said.

He pointed out that Japan's economy has hit bottom and will now move toward the recovery phase, but noted the pace of economic recovery will be modest.

As for economic recovery, "There are views, such as V-shaped or U-shaped recovery. The pace of economic recovery will be modest but the economy will recover steadily," Kuroda said.

He also warned of the risk that if the pandemic is prolonged, liquidity issue would turn to solvency. But he downplayed an imminent risk, saying that he isn't worried about the risk now. However, he added that solvency was a government issue.

--INFLATION EXPECTATIONS

Short-term inflation expectations fell in the wake of the drop in crude oil price but medium- to long-term inflation expectations didn't fall, meaning that Japan will not fall into deflation.

Excessive drop of super long-term government bonds yields will have an adverse impact on pension funds and life insurance firms in addition to sentiment.

"The BoJ must keep entire yield curve at low level," Kuroda said.

Kuroda said that the BoJ will not change the 2% price target, although Japan is far from hitting it.

"The 2% price target hasn't been achieved in other nations. But I don't see the need of changing (or lowering) the target at all," Kuroda said.

BoJ Outlook for Economic Activity and Prices - July 2020

Forecasts of the Majority of the Policy Board Members

y/y % chg.

	Real GDP	CPI (all items less fresh food)	(Reference) Excluding the effects of the consumption tax hike and policies concerning the provision of free education
Fiscal 2020	-5.7 to -4.5 [-4.7]	-0.6 to -0.4 [-0.5]	-0.7 to -0.5 [-0.6]
Forecasts made in April 2020	-5.0 to -3.0	-0.7 to -0.3	-0.8 to -0.4
Fiscal 2021	+3.0 to +4.0 [+3.3]	+0.2 to +0.5 [+0.3]	
Forecasts made in April 2020	+2.8 to +3.9	0.0 to +0.7	
Fiscal 2022	+1.3 to +1.6 [+1.5]	+0.5 to +0.8 [+0.7]	
Forecasts made in April 2020	+0.8 to +1.6	+0.4 to +1.0	

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. In the April Outlook Report, each Policy Board member made their forecasts as a range and submitted two figures (i.e., the highest and lowest figures) within the range of 1.0 percentage point at most. The forecasts of the majority of the Policy Board members were shown as a range excluding four figures -- namely, the two highest figures and two lowest figures among the forecasts of the nine members. Thus, it should be noted that the definition of the forecasts of the majority of the Policy Board members in the April Outlook Report is different from that in the July Outlook Report.

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

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

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Analysts' Key Comments

Barclays:

- The BoJ wrapped up its two-day MPM with a majority decision to retain current policies, in line with market expectations. With the economy showing a tentative recovery as activity resumes and fiscal expenditure under the emergency economic measures kicking into full gear in Q3, we believe the BoJ will take a wait-and-see stance in the near term to observe the effects of the various measures it has taken since March.
- Accommodative financial conditions backed by stable equity prices and exchange rates are another factor enabling the BoJ keep any additional easing measures on hold. Assuming financial conditions remain stable, we expect the BoJ to stick with its current easing policy through our FY20-21 forecasting horizon.
- While other major central banks start to follow in the BoJ's footsteps, the BoJ is shedding light on a medium/long-term course for policy through its decisions since March, including those at unscheduled meetings. Specifically, it is 1) financially supporting fiscal expansion through quantitative easing (QE) and yield curve controls (YCC), and 2) strengthening support for corporate finance to supplement credit creation, while 3) turning away from further easing via the negative interest rate policy (NIRP) to avoid unwanted side effects.
- Its support of fiscal expansion through QE and YCC effectively amounts to something akin to debt monetization. In our view, the BoJ experience shows that such a policy spurs a decline in fiscal discipline, but nevertheless represents a highly sustainable form of extraordinary easing.
- In its quarterly Outlook Report, released at the end of the MPM, the BoJ updated its real GDP growth and core CPI inflation forecasts for FY20-22. The BoJ continued to diverge far from market consensus, including Barclays, in its outlook for the latter to return to positive territory in FY21..

Goldman Sachs:

- As was widely expected, the Bank maintained the status quo in all key monetary policy areas, including short- and long-term policy rates, JGB and risk asset purchase guidelines, and the special program for supporting the financing of companies. The Summary of Opinions from the June MPM included comments by some policy board members that COVID-19 response measures are largely in place, and we believe the BoJ will continue to monitor the effectiveness of these measures for the time being.
- In the quarterly Outlook Report, the BoJ announced median figures for policy board members' forecasts, which it had not announced in the last report. The largest change was to the real GDP outlook for FY2020. The BoJ announced a median figure of -4.7% (with a range of -4.5% to -5.7%), near the bottom end of the range announced in January (-3.0% to -5.0%). This is largely in line with our forecast.
- The BoJ's view on current overall economic conditions was unchanged at "extremely severe," but by component, its assessment for consumption was revised upward with the phrases "private consumption...has shown signs of a pick-up recently." On its outlook, the BoJ maintains a recovery scenario beginning 2H2020, but remains cautious, noting in particular that "the pace of improvement is expected to be only moderate while the impact of COVID-19 remains worldwide," and "with regard to the risk balance, risks to both economic activity and prices are skewed to the downside."

HSBC:

- On hold, as widely expected. The Bank of Japan (BoJ) kept its policy settings unchanged, with its short-term policy rate at -0.10% and the 10-year Japanese Government Bond (JGB) yield target at "around" 0.00% (+/- 20bp) under Yield Curve Control (YCC), as forecasted by HSBC and consensus. Meanwhile, the guidelines for asset purchases in the official statement were also unchanged, with JGB purchases to be conducted "without setting an upper limit" (link to statement).
- The BoJ's new forecasts for growth and inflation fell closer to the lower bound of the April expectations (note that the Bank only provided a range last time). Still, the Bank maintained the view that a moderate recovery is likely from the second half of the fiscal year. In details, real GDP is forecasted to contract 4.7% in FY2020 and increase 3.3% in FY2021, while core inflation is likely to stay weak in the foreseeable future at a negative 0.5% this fiscal year and marginally positive at 0.3% in the next fiscal year.
- BoJ Governor Haruhiko Kuroda maintained a relatively optimistic view on the economy, saying that some gradual improvement is likely from 2H20 and inflation expectations are holding up. He also said that the Bank is not planning to change the price stability target of 2%. Moreover, once again, he added that the

BoJ will not hesitate to ease further, if needed, which could take the form of increasing funding programs or lowering rates. Meanwhile, in terms of the recent increase in JGB yields, the governor said that it is important for yields to stay low and stable, but also stated that excessively low super long yields could be problematic.

J.P.Morgan

- The BoJ stayed on hold as expected. The Outlook Report showed that Japanese economy has been in an extremely severe situation, and likely will improve gradually from 2H of this year, but the pace is expected to be only moderate. It also showed CPI will likely be negative for the time being, and is expected to turn positive and increase gradually, but even in FY2022 the median forecast will be 0.7%, far below the 2% target. All the forecast numbers are consistent with our expectations (though market consensus was different in that the BoJ would show the outlook by the ranges). The BoJ emphasized the downside risks for both growth and inflation outlook, but strengthened the downside risk assessment by adding the uncertainty about assuming no second wave of COVID-19 on a large scale. Regarding its inflation outlook, the BoJ admitted that inflation expectations weakened, but indicated not only the downside risks but also the upside risk over the firms' price setting behavior if the economic activity is constrained from the supply side.
- Overall, since the BoJ had already prepared enough measures for emergency period by the June MPM, and Japanese economic activities have actually resumed gradually, it decided to stay on hold. However, there are a lot of uncertainties surrounding Japanese economy and even the BoJ doesn't foresee the inflation will move closer to the target even within FY2022. Thus we have to check how the BoJ will let Japanese economy revive and the inflation move closer to the target despite taking a time from now on. Let's check to what extent the additional strengthening of the easing policy comes into the BoJ's sight by hearing Kuroda's intention at the press conference which will start soon.

Mizuho:

- The BoJ policy board voted to leave monetary policy unchanged at its two-day meeting that concluded on July 15. The Outlook report, published at the meeting's conclusion, noted "Japan's economy has been in an extremely severe situation with the impact of COVID-19 remaining at home and abroad, although economic activity has resumed gradually."
- As to the outlook, it forecasts that "Japan's economy, with economic activity resuming, is likely to improve gradually from the second half of this year through the materialization of pent-up demand and supported by accommodative financial conditions and the government's economic measures. However, the pace of improvement is expected to be only moderate while the impact of COVID-19 remains worldwide."
- The Bank acknowledges "extremely high uncertainties over the consequences of COVID-19" and talks about the risk of a second wave. The risk balance is "skewed to the downside."
- The median forecasts of the majority of board members, published as reference, included a de-facto downward revision to real FY20 GDP to take account of the corona crisis. They also show that core CPI inflation is not expected to even approach the 2% target by FY22.
- QQE was already looking like a permanent state of affairs before the pandemic hit; that outlook is becoming ever more certain

Societe Generale

- Ahead of the July policy meeting, various policy board members had indicated that enough policy action has been undertaken for the time being. In line with market expectations, the BoJ policy board decided to remain on hold at the meeting held on 14-15 July.
- A new outlook report on developments since April was released at the July meeting. Reflecting the continuing weakness in economic data, it revised down its GDP and CPI forecast for FY20 but revised up its forecasts for FY21 and FY22. The main scenario for the BoJ is that a second wave of COVID-19 will not have a strong impact and economic activity should start to recover from the second half of the year. Furthermore, the BoJ continues to indicate that it is ready to act with further easing if it deems it necessary.
- With Japan's credit cycle and investment cycles swung to the upside, our view for now is that the economy has avoided a L-shape recovery. We continue to believe that the government will move forward with another round of fiscal stimulus of around 1-2% of GDP by the end of the year. The next round of stimulus

will aim to increase the likelihood of a V-shape recovery if COVID-19 shows further signs of containment or to further cushion the effects of COVID-19 if signs of a second wave strengthens.