MNI BOJ Review - October 2020

Meeting Date: Wednesday October 28 - Thursday October 29 2020

Link To Statement: https://www.boj.or.jp/en/announcements/release_2020/k201029a.pdf

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MNI POV (Point Of View): No Change, Downside In Focus

The BOJ left its monetary policy settings unchanged at its October meeting and delivered economic projections that were broadly in line with the various source reports that hit in recent weeks (**click here** for the Bank's Outlook for Economic Activity and Prices update). As we flagged ahead of the decision, the adjustments made to the economic forecasts should be of no meaningful consequence for monetary policy.

The Bank also reiterated its forward guidance, once again matching expectations, and leaving no real scope for any long-term evolution in expectations surrounding Japanese monetary policy.

Kataoka provided the usual source of dovish dissent, covering familiar matters, which was once again in line with broader expectations.

The notable headwinds for inflation were already known i.e. crude prices, global demand owing to COVID-19 and the government's Go-To Travel campaign, which the Bank duly flagged.

The BOJ was also keen to stress the uncertainty surrounding the economic outlook, while noting that risks for the economy are skewed to the downside, which provided no source of shock. Ultimately, the Bank believes that "the economy is projected to keep improving further with overseas economies returning to a steady growth path."

We should caution that the Bank's assumptions regarding the economic outlook are based on the premise that COVID-19 will not be as widespread as it was previously, an assumption that could be tested if the recent developments and resulting lockdowns in Europe are anything to go by.

On the currency front, Governor Kuroda noted that the yen has "been moving in a tight range and is relatively stable, compared with stock and bond markets," showing comfort with the current state of play in the currency market.

As we noted ahead of the decision, a deeper move into negative rate territory would likely only be forthcoming if there is a structural shift in real rate spreads with the U.S. or in the case of notable, sustained JPY strength, with market participants expressing a clear near-term focus on the impact of the upcoming U.S. Presidential election.

Governor Kuroda also revealed that the BOJ will further extend its corporate lending facilities if required, but stressed that a decision on that matter will not be taken until nearer the current planned expiration of the outstanding credit provisions (March 31). As we noted ahead of the decision, this makes sense, especially with the government seemingly set to out lay its next round of (fairly limited) fiscal support in the coming weeks.

MNI REVIEW: BOJ Stands Pat on Policy; Keeps Forward Guidance

By Hiroshi Inoue

TOKYO (MNI) – The Bank of Japan board Thursday kept monetary policy and the forward guidance for policy rates unchanged, indicating policymakers remain vigilant about the impact of the coronavirus on the economy and financial markets, reserving some ammunition for future use.

The central bank cited the gradual recovery in the economy, helped by exports and industrial production, for the widely expected decision.

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

VOTE

On monetary policy, the board voted 8-to-1 to stand pat on the yield curve control policy and asset purchases, maintaining its recovery scenario was based on accommodative financial conditions and the government's economic measures. Under the yield curve control framework adopted in September 2016. The BOJ will also keep the target for the overnight interest rate at -0.1%.

In its statement, the central bank said it will continue buying JGBs to stabilise the 10-year yield "around zero percent" without a limit on total purchases. However, it will also allow the long-term interest rate to "move upward and downward to some extent, mainly depending on developments in economic activity and prices".

The BOJ also left the annual scale of ETF (exchange-traded funds) and J-REIT (Japan real estate investment trusts) purchases unchanged, with the upper limit at about JPY12 trillion and about JPY180 billion, respectively.

DISSENT

Goushi Kataoka, a former private-sector economist, dissented on the policy decision, considering it desirable to strengthen monetary easing by lowering the 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.

Kataoka also dissented on forward guidance, saying that further coordination of fiscal and monetary policy was necessary, judging from the severe impact of Covid-19 on the economy.

MNI POLICY: MNI POLICY: BOJ To Extend Facilities As Needed, Kuroda Says

By Hiroshi Inoue

TOKYO (MNI) - The BOJ will extend its lending facilities if needed but a decision will not be taken until nearer March 31, when the current facilities are due to expire, Bank of Japan Governor Haruhiko Kuroda said Thursday, although he declined to comment when that decision could be, saying it was dependant on corporate financing developments and banks' lending attitude.

He said the BOJ kept the policy under constant observation, but noted any extension, if forthcoming, would be on the same terms as current.

Speaking to the press following the Bank of Japan's latest policy meeting, Kuroda again said he saw no need to change the BOJ's 2% price target and that goal remains appropriate. He didn't think recent declines in prices due to government plans would lead to a change in underlying price trends, despite the 2021 Outlook downgrade.

MARKETS

With one eye on next week's U.S. Presidential election, Kuroda said the BOJ is watching major global events and their impact on financial markets

Asked about forex moves, Kuroda said the forex rate has "been moving in a tight range and is relatively stable, compared with stock and bond markets", indicating the same direction of monetary and fiscal policies by the U.S. and Japan is behind a stable dollar/yen rate.

Kuroda sees no need of changing the frequency and the scale of longer-end JGB buying, although the supply-demand conditions will become tighter as life insurance firms increase their purchases of longer-end bonds.

The governor also attempted to justify the BOJ's ETF buying, saying the bank continues buying ETFs in a flexible manner and would continue with purchases to lower risk premium under the current policy framework.

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Analysts' Key Comments

Goldman Sachs:

As was widely expected, the BOJ maintained the status quo in all key monetary policy areas, including short- and long-term policy rates (yield curve control), JGB and risk asset purchase guidelines, and the special program for supporting corporate financing.

- In the US, the Fed revised its forward guidance at the September FOMC meeting, bringing it in line with its newly-adopted "average inflation target". While some market participants were watching to see what the BOJ would do, forward guidance remains unchanged, too. The BOJ said that it would continue with "Quantitative and Qualitative Monetary Easing with Yield Curve Control," aiming to achieve a price stability target of 2%, as long as it was necessary for maintaining that target in a stable manner. In addition, the BOJ maintained its "overshoot commitment", considered by BOJ Governor Kuroda as similar in concept to the Fed's average inflation target.
- Although corporate demand for funds has eased substantially after peaking in Q2, the balance in the BOJ's special program to support corporate financing is still increasing. Under this program, the government provides companies with not only the interest payable on loans but also assurances from credit guarantee associations, while the BOJ provides liquidity to financial institutions, which actually extend loans to companies. We think that these advantageous conditions are boosting corporations' demand for the program, as well as stimulating financial institutions' incentive to lend.
- Given the poor visibility on the spread of COVID-19 ahead, we think the BOJ will likely focus on the smooth implementation of this program, as it has done to date. As the current program (together with the increase in the purchase budget for commercial paper/corporate bonds) is temporarily set to end in March 2021, we think the decision to extend the timeframe for these measures will likely be made over the year-end. During today's press conference after the MPM, Governor Kuroda reiterated the BOJ's view that it would consider extending the timeframe if needed.
- In terms of policy measures other than COVID-19 response, we think the BOJ will likely continue to adjust JGB purchasing passively to facilitate additional issuance by the government, thereby keeping the yield curve low and stable. We also think the BOJ will be keen to avoid taking the short-term policy rate deeper into negative territory, as doing so could increase stresses on the financial system. The situation warrants attention, however, as the BOJ might opt for deeper negative rates in the event that USD/JPY were to break below 100, while acknowledging the potential side-effects. In this context, our near-term focus is on what impact the outcome of the November 3 US presidential election could exert on the forex market.

J.P.Morgan:

- At today's monetary policy meeting (MPM), the BoJ stayed on hold as expected (see the details here). At the press conference after that, Kuroda expressed four important views. Based on his explanation, we expect the extension of current emerging measures will be the focus for the time being, and the discussion of stimulating the economy and prices may start later next year if weak economic growth and no or very anemic price growth persists, given the limited room for further easing.
- First, regarding the current three pillars for the COVID-19 crisis (special measures for alleviating the funding difficulties of firms, measures for stabilizing markets, and containing the risk premium of asset markets), Kuroda expressed that the first pillar has been effective and most firms have already met their funding needs through the end of this year. But he also said whether they can fully meet their funding needs over the fiscal year (the end of March) remains to be seen, and the BoJ would extend the expiration date (the end of March) if necessary, after inspecting their funding conditions and profitability. He reiterated that the BoJ isn't thinking of changing the framework of three pillars, but could expand their size depending on the size of downside risks. The severity of their financial conditions varies depending on the industry, but so far has improved overall because Japan is seeking of an approach that involves the coexistence of the activation of economic activity and containment of COVID-19 infections. Based on this, we continue to expect that the BoJ will decide to extend this first pillar at December or January MPM.

- Second, asked about the global risks concerning the US election and its impact on financial markets and the increase in the number of infections in Europe, Kuroda seems to be concerned more over the latter. Having said that, Kuroda reiterated that each government in DMs is seeking a compatible way for both the activation of economic activities and the containment of infections, so that he doesn't expect the crisis-type deterioration of the economy to come in DMs.
- Third and most importantly, Kuroda stressed that the BoJ has not changed the characteristics of the 2% inflation target to a medium-term target, and is seeking to achieve the target at the earliest possible time. He said these characteristics are still appropriate not only in Japan but also in many DMs. However, he also emphasized that the current economic and financial conditions have not exited entirely from the crisis situation under COVID-19, so that the BoJ is thinking it is appropriate to continue with the above-mentioned three pillars, which also has the effects of avoiding deterioration of economic growth and price growth. He provided the view that the current weak prices reflect largely the impact of the fall in energy prices and of the government subsidy program for travel expenses (-0.2%pt contribution to core CPI in FY2020), so that price fall is concentrating in specific areas and temporary. Kuroda said that after the current emergency situations are alleviated, the BoJ should gear toward more emphasis on raising the economic growth and inflation. He assessed that the BoJ is not at the stage of stimulating the economy and prices broadly, which may suggest that the BoJ likely will start discussing how to stimulate the economy and prices more in the 2H of next year if the pace of economic recovery and price growth are anemic, in our view, given the external conditions and limited room for further easing.
- Lastly, when asked about the risk to the financial system, Kuroda said that the risk of destabilizing the financial system and its negative impact on the credit intermediation function is not large as of now, but attention should be paid to the potential risk that persistent stagnation and large shock to the financial markets could induce such a situation, and the BoJ is coordinating with the FSA about this concern..

Societe Generale:

The BoJ remained on hold at its October policy meeting with no change to its easing policies. The new outlook report indicates that BoJ continue to see the worst of the COVID-19 impact as over and that economic activity is restarting. However, with households and businesses still cautious and still no pick-up in demand, especially for services, the recovery could take longer than previously anticipated Furthermore, the government's campaign to promote tourism and its push to cut mobile communication fees is acting as a strong headwind to prices.

- With the risk of a second wave of infection continuing to linger, the BoJ is maintaining its cautious attitude while keeping its firm commitment to the current easing framework. The new government has also clearly stated it is committed to achieving the 2% inflation target jointly with the central bank. However, with global central banks remaining accommodative for longer and prices not picking up as quickly expected, the hurdle to policy normalisation remains high. We still think the BoJ will not be able to move forward with any policy change until 2023, and that full normalisation of monetary policy will likely not occur during Governor Kuroda's tenure.