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Economic Research View

Japan: First Impression of BOJ July Monetary Policy Meeting

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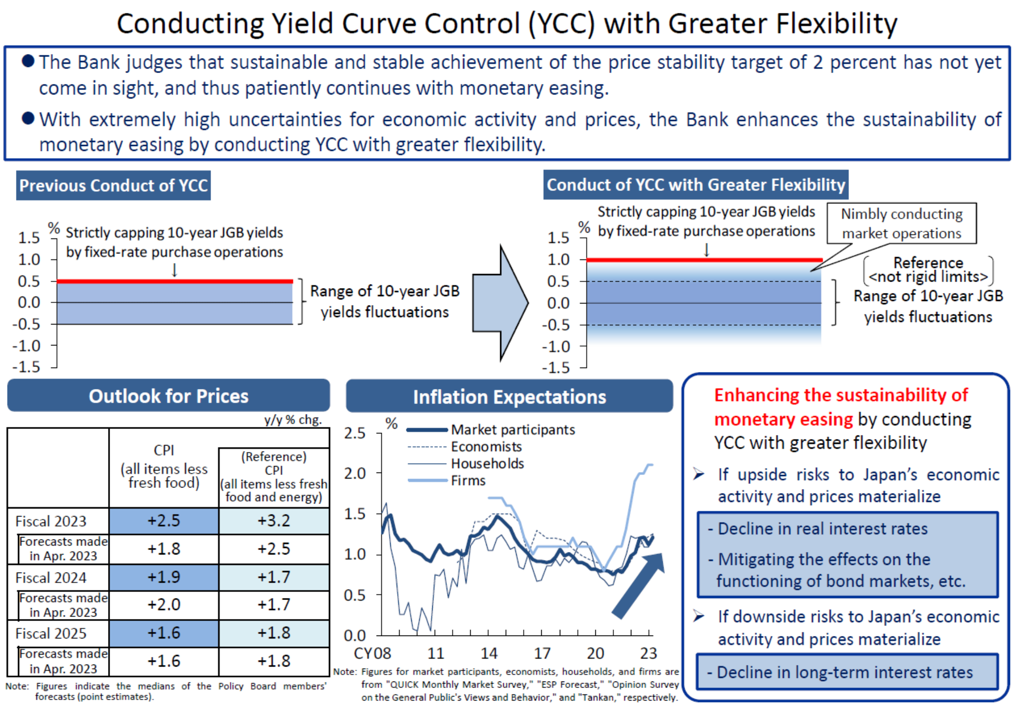
At the Monetary Policy Meeting held from July 27 to 28, the Bank of Japan (BOJ) decided to bring greater flexibility regarding Yield Curve Control (YCC) measures in order to strengthen the sustainability of monetary easing. The central bank raised its price outlook for fiscal 2023, but said it was "more or less unchanged" for fiscal 2024 and 2025 and does not expect to achieve the 2% price stability target in a sustainable and stable manner. The 10-year bond yield fluctuation range of about ±0.5% is now described as “reference” rather than “rigid limits”. Additionally, the Bank mentions that it will offer to purchase 10-year JGBs at 1.0 percent every business day through fixed-rate purchase operations, although no bids are expected to be submitted under the current interest rate environment, implying that the Bank has effectively removed the cap on long-term interest rates nonetheless paying attention to any rapid increase in the interest rates. BOJ Policy Board might have been afraid to let go of YCC completely, so it might have presented ±50bp as a reference range and attached a right to execute limit operations to maintain it for the time being.

- At the Monetary Policy Meeting held from July 27 to 28, the Bank of Japan decided to bring greater flexibility regarding Yield Curve Control (YCC) measures. It said that conditions do not support expectations of achieving the 2% price stability target in a sustainable and stable manner, and that monetary easing must be continued persistently under the current policy "framework" and that the measures were designed to respond flexibly to upside and downside risks given the extremely high level of economic and price uncertainty. The report is largely in line with my expectation that the central bank will make adjustments to strengthen the sustainability of monetary easing, not necessarily because it is more confident that it will achieve its inflation target.
- Specifically, the fluctuation range in the yield curve control for 10-year bonds has been changed from "rigid limits" to "reference" with its range upper limit set at 100 basis points. In the Bank of Japan's wording, the scope of “reference” is quite broad. If there are no bids for a fixed-rate purchase operations without reaching the limit of 100bp for a certain period of time, the 100bp consecutive purchase operation itself may be withdrawn.
    - ✓ June 2023: The Bank will continue to allow 10-year JGB yields to fluctuate in the range of around plus and minus 0.5 percentage points from the target level, and will offer to purchase 10-year JGBs at 0.5 percent every business day through fixed-rate purchase operations, unless it is highly likely that no bids will be submitted.
    - ✓ July 2023: The Bank will continue to allow 10-year JGB yields to fluctuate in the range of around plus and minus 0.5 percentage points from the target level, while it will conduct yield curve control with greater flexibility, regarding the upper and lower bounds of the range as references, not as rigid limits, in its market operations. The Bank will offer to purchase 10-year JGBs at 1.0 percent

every business day through fixed-rate purchase operations, unless it is highly likely that no bids will be submitted.

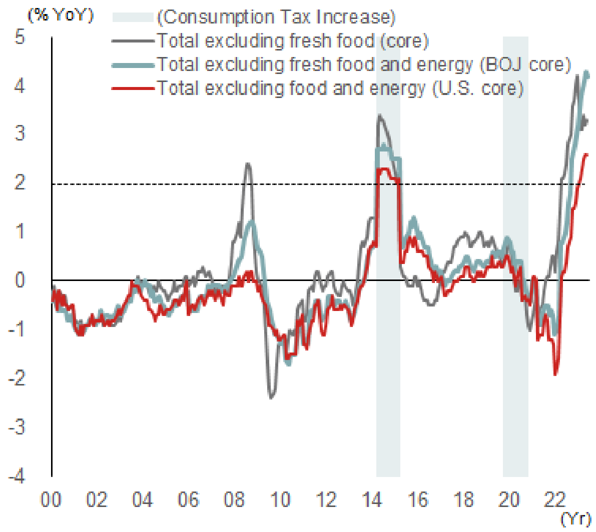
- From the evening of July 21, there were a series of observational reports, and Reuters said, "Maintain status quo, YCC unchanged" but the English version and the Yomiuri Shimbun on the 22nd said, "While maintaining the YCC framework, modifications are possible". As market sentiment tilted towards "50/50, slightly closer to maintaining the status quo", the Nikkei reported in the middle of the night that "BOJ proposes to allow rate manipulation to exceed 0.5% limit" and the yen strengthened a little rapidly in the foreign exchange market. In the bond market on July 28, the 10-year yield exceeded the upper limit of 50 basis points and bids were placed for a range bound operation. I was a bit less certain given such media coverage in the previous week to the Monetary Policy Meeting, but maintained my expectation that the YCC would allow greater flexibility in July, given comments made such as Vice-Minister of Finance for International Affairs Masato Kanda's attempt to give the impression of "pushing back the status quo" as well as Reuters' reports in English. I had expected that the BOJ Board would withdraw the 50 basis points fixed-rate purchase operation on a daily basis and move to de-facto elimination of YCC, but the result was a 100 basis point range bound operation. However, it is likely that the difference is not substantial.
- "Signs of change have been seen in firms' wage- and price-setting behavior, and inflation expectations have shown some upward movements again." the BOJ statement said. If the trend continues in the upward direction, (1) A decline in real interest rates could strengthen the monetary easing effect, while (2) A strict cap on long-term interest rates could affect the functioning of the bond market and volatility in other financial markets. The decision was made to balance the effects and side effects. The outlook for monetary policy is expected to remain unchanged for the rest of the year. It is expected that a clearer decision will be made on the negative interest rate and the YCC framework themselves after next spring.

Figure 1. BOJ's Greater Flexibility of Yield Curve Control



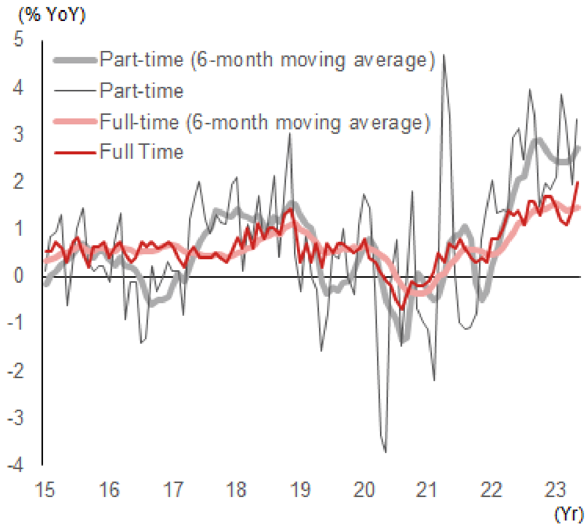
Note: Nomura Asset Management based on Bank of Japan data. https://www.boj.or.jp/en/mopo/mpmdeci/mpr_2023/mpr230728d.pdf

Figure 2. U.S. core consumer prices continue to rise



Source: Nomura Asset Management based on data from the Ministry of Internal Affairs and Communications Bureau of Statistics

Figure 3. Changes in scheduled cash earnings



Source: Source: Nomura Asset Management based on CEIC data.

Figure 4. Policy Committee members' economic and price outlook and risk assessment

		As of April 2023			As of July 2023		
		FY 2023	FY 2024	FY 2025	FY 2023	FY 2024	FY 2025
Real GDP	Median (%, YoY)	1.4	1.2	1.0	1.3	1.2	1.0
	Range (%, YoY)	1.1~1.5	1.0~1.3	1.0~1.1	1.2~1.5	1.0~1.3	1.0~1.2
	Risk Balance (persons)	Balanced 3 Upside 2 Downside 4	Balanced 6 Upside 1 Downside 2	Balanced 8 Downside 1	Balanced 3 Upside 2 Downside 4	Balanced 2 Upside 4 Downside 3	Balanced 7 Upside 1 Downside 1
Consumer Price Index (Excluding Fresh Food)	Median (%, YoY)	1.8	2.0	1.6	2.5	1.9	1.6
	Range (%, YoY)	1.7~2.0	1.8~2.1	1.6~1.9	2.4~2.7	1.8~2.2	1.6~2.0
	Risk Balance (persons)	Balanced 2 Upside 7	Balanced 4 Upside 3 Downside 2	Balanced 5 Upside 1 Downside 3	Balanced 4 Upside 5	Balanced 1 Upside 5 Downside 3	Balanced 4 Upside 2 Downside 3
Excluding Fresh Food and Energy	Median (%, YoY)	2.5	1.7	1.8	3.2	1.7	1.8
	Range (%, YoY)	2.5~2.7	1.5~1.8	1.8~2.0	3.1~3.3	1.5~2.0	1.8~2.0

Source: Nomura Asset Management based on Bank of Japan data.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.

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