Economic Research View

Bank of Japan Monetary Policy Review and Outlook

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In the foreign exchange market on April 30, the yen weakened, temporarily exceeding 160 yen, before rapidly strengthening, leading to speculation about intervention by the Ministry of Finance. The Bank of Japan's (BOJ's) low alertness regarding the yen's weakness and perception as being "dovish" as per April 25 and 26 monetary policy meeting are said to be the main reasons for the acceleration of yen depreciation. However, during the BOJ governor's post-policy meeting press conference, it was suggested that if prices increase continue as expected, the neutral interest rate may be reached in the latter half of the outlook period, indicating that the overall stance may not be as dovish as initially perceived. Taking these factors into consideration, as it may be difficult to raise interest rates in September-October due to the political situation, there is a sufficient possibility of a rate hike in July. On May 9, the "Summary of Opinions" from the monetary policy meeting were disclosed. References to the upside risk of inflation due to yen depreciation were notable, and there were also comments hinting at the possibility of accelerating rate hikes if yen depreciation leads to higher-than-expected underlying inflation. Explicit quantitative tightening (QT) could be decided relatively early if there is an additional rate hike in July and global interest rates stabilize, and it could be said that the "Summary of Opinions" support such expectations.

The situation surrounding the Bank of Japan has been becoming similar to the 2022 currency intervention and Yield Curve Control relaxation.

- In the foreign exchange market, following the Bank of Japan's (BOJ's) decision on April 26 and the BOJ governor's press conference, the yen rapidly weakened. On the morning of April 29, the yen temporarily depreciated to 160.17 yen against the US dollar, but later strengthened to the 155 yen range, then returned to the 157 yen range, and eventually rose to the mid-154 yen range, with fluctuation during Japan's public holiday. On the following day on April 30, the yen returned to a depreciation trend, but on May 2, the yen rapidly appreciated again. On May 3, following the results of the US employment statistics, the yen temporarily appreciated to below 152 yen. Currently, there is a trend of yen depreciation again, and the yen is trading at approximately mid-155 yen.
- The rapid appreciation of the yen is believed to have been triggered by intervention in the foreign exchange market by the Ministry of Finance. On April 29, Vice-Minister of Finance for International Affairs Masato Kanda stated, "The significant and abnormal fluctuations due to speculation could have an undeniable negative impact on the national economy", and mentioned that they would continue to take appropriate measures as necessary, stating that they could respond 24 hours a day, 365 days a year. However, he did not comment on whether there had been intervention in the foreign exchange market. While foreign exchange intervention may not necessarily reverse the long-term depreciation trend of the yen, it could play a role in "speed adjustment" through deterrence against speculators. In

fact, speculative net short positions in yen have increased compared to the time of the 2022 intervention. The level of the yen exchange rate may not always trigger intervention, but it is likely that alertness regarding intervention will increase as the yen approaches 160 yen due to the recent movements that appear to be intervention in the foreign exchange market.

- Regarding the April Monetary Policy Meeting, on the evening of the first day of the meeting on April 25, there was a media coverage that reported that the BOJ is considering reducing government bond purchases, moving towards de facto quantitative tightening. Such "pre-meeting reports" have generally been accurate in the past, and there was a growing expectation that even without a rate hike, an announcement of a reduction in government bond purchases could be made. However, the policy statement did not indicate a reduction in government bond purchases, and during Governor Kazuo Ueda's press conference, when asked if “the monthly purchase of 6 trillion yen would continue for the time being”, he answered "as you pointed out," indicating that a clear statement on quantitative tightening (QT) would not be implemented in the near term. (Additionally, Governor Ueda also mentioned that "the Financial Markets Department would decide within a certain range," suggesting that reducing the monthly pace from 6 trillion yen to around 4.8 trillion yen is possible). Furthermore, Governor Ueda mentioned that the current yen depreciation is not having a significant impact on underlying inflation, suggesting a low level of alertness regarding the yen’s weakness and the possibility of being perceived as dovish.

- However, is the BOJ truly dovish? In the governor's press conference, statements were made indicating that: 1) The policy interest rate should be rising to around the neutral interest rate in the latter part of the outlook period, 2) If prices develop as expected, rate hikes should continue (further upside is not necessary, and if there is an upside, it would be a reason for further adjustment), 3) It is important to balance "being cautious because the impact of rate hikes on the economy is highly uncertain" with "doing so slowly, which may lead to a sudden shock at some point." These statements indicate that there is a recognition that the BOJ is currently in a rate-hiking phase. The "Outlook for Economic Activity and Prices" states that adjustments will be made to the degree of monetary easing, suggesting a high possibility of additional rate hikes.

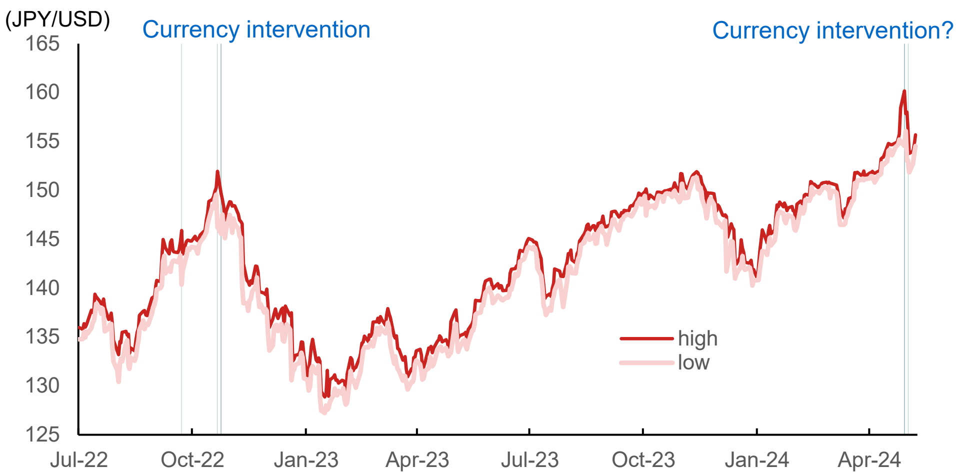
- Unlike the Fed, the BOJ has not explicitly stated its neutral interest rate but in its Review of Monetary Policy from a Broad Perspective, it has shown estimates of the natural interest rate from five models, with a range of around "-1.0% to +0.5%." This is in real terms, so in nominal terms, if inflation expectations are anchored at 2%, the range for the neutral interest rate would be around "+1.0% to +2.5%." (Currently, Governor Ueda is believed to assume inflation expectations of around 1.5%). The BOJ may consider that by the latter part of the outlook period ending in March 2027, at least a policy rate of +1.0%, or around 1.5% on average. Therefore, if the neutral interest rate is reached by October 2026 and assuming rate hikes at an equal pace, with increments of 25 basis points each time, it is expected to be at a pace of once every six months (0.25% in October 2024, 0.5% in April 2025, 0.75% in October 2025, 1.0% in April 2026, and 1.25% in October 2026, considering a margin of error of about ±1 rate hike based on economic and price considerations, reaching a level of around 1.0-1.5% is expected).

- As for the discrepancy between the "pre-meeting reports" and the actual results regarding government bond purchases, there may have been a heightened awareness of the risks of relinquishing control, mainly due to upward pressure on global interest rates driven by factors in the United States. Ideally, the BOJ would prefer to decide on a decrease in bond purchases when global interest rates are stable, regardless of the economic and price situation.

- From the above, if we assume that there was no "pre-meeting report," and upon closer examination, the BOJ's decision and the BOJ governor's press conference in April may not be all that "dovish." However, the perception that the BOJ has low alertness regarding the yen’s weakness and is dovish led to the acceleration of yen depreciation. While it is possible that the Ministry of Finance intervened to adjust the speed of the yen’s depreciation, the BOJ may also be required to exhibit more "hawkish" behavior in the future (in fact, in 2022, after interventions were carried out in September and October, a decision was made to relax the Yield Curve Control in December).

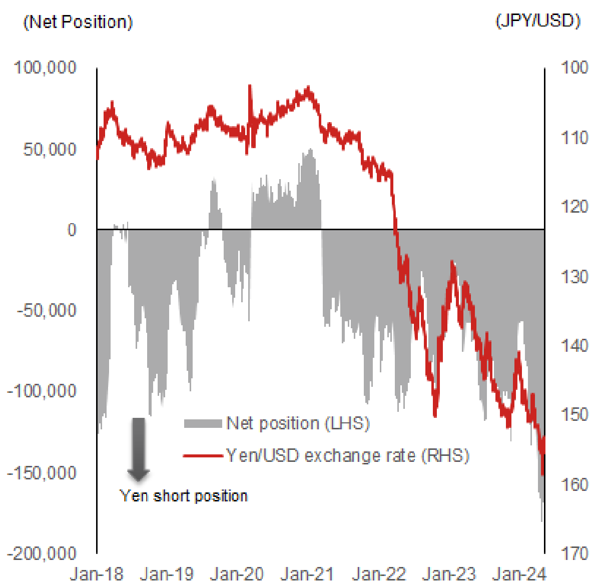
- On May 9, the "Summary of Opinions" from the monetary policy meeting were disclosed. References to the upside risk of inflation due to yen depreciation were notable, and there were also comments hinting at the possibility of accelerating rate hikes if yen depreciation leads to higher-than-expected underlying inflation. Explicit quantitative tightening (QT) could be decided relatively early if there is an additional rate hike in July and global interest rates stabilize, and it could be said that the "Summary of Opinions" support such expectations.
- Furthermore, in the lower house by-elections on April 28th, the ruling Liberal Democratic Party (LDP) not only failed to field candidates in two constituencies but also lost in the 1st district in Shimane Prefecture, known as the "conservative kingdom." Additionally, an NHK national broadcast declared the victory of the main opposition Constitutional Democratic Party candidates in all three districts almost simultaneously at the closing of the voting at 8 p.m., indicating that the losses were not by a narrow margin. Considering these circumstances, it is generally deemed difficult for the dissolution of the Diet at the end of the term in June, and the likelihood of a dissolution general election after the LDP leadership election in September has increased. Taking into account the current situation where the BOJ is being blamed for the acceleration of yen depreciation, and furthermore that the BOJ itself is considering continuing rate hikes as a baseline and that rate hikes in September-October will be difficult due to the political situation, there is a sufficient possibility of a rate hike in July.

Figure 1. Dollar-yen movements and currency intervention



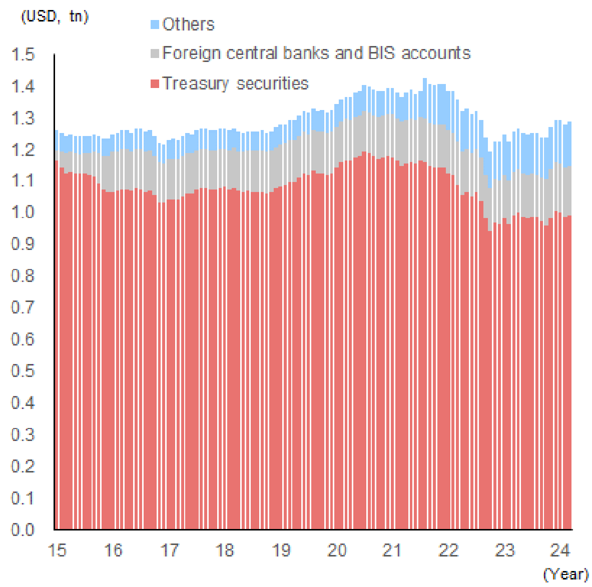
Source: Nomura Asset Management based on Bloomberg data. From Jul 1, 2022 to May 8, 2024, daily.

Figure 2. Yen selling positions by speculators



Source: Nomura Asset Management based on Bloomberg data.
From Jan 1, 2018 to May 8, 2024, daily.

Figure 3. Japanese foreign exchange reserves



Source: Nomura Asset Management based on Ministry of Finance data.
From Jan 2015 to Mar 2024, monthly.

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