Liquid Insight

BoJ preview: Long time coming

13 March 2024

Rates and Currencies Research
Global

Key takeaways

- Mar/Apr BoJ policy shift a done deal. Strong FY24 Shunto, recent newsflow suggest BoJ may exit NIRP/YCC at the 19 Mar MPM.
- Rates: BoJ is likely to keep its excessive JGB purchases, which should contain a rise in JGB yields.
- FX: Buy USD/JPY's dip. NIRP/YCC removal not yen supportive if guidance not hawkish. We discuss various market scenarios.

By Izumi Devalier/Shusuke Yamada / Takayasu Kudo / Tomonobu Yamashita

Chart of the day: Expected market reactions (immediate - 1 week) to various scenarios at the 19 March MPM

Tone of BoJ guidance key for FX/rates reaction to a potential NIRP/YCC exit at the March MPM

	USD/JPY	10yr JGB
No change, but send strong signal for April	148-150	Fall to 0.70%
NIRP/YCC exit, with very dovish guidance	149-151 with risk of FX intervention above 152	Unchanged
NIRP/YCC exit, with moderately dovish/balanced guidance (BofA base case)	146-148	Rise to 0.80%
NIRP/YCC exit, with somewhat hawkish guidance	144-146	Rise to 0.85%

Source: BofA Global Research; Note: Relative to spot USDJPY: 147.3; 10yr JGB yield: 0.763%

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We expect the BoJ to exit NIRP/YCC at the March MPM

The Bank of Japan concludes its next policy meeting, on 19 March. While a March move is not yet a done deal, we see a higher probability that the BoJ will declare its 2% price stability target "in sight" and announce an exit from NIRP/YCC next week (see BoJ watch: moving our base case for BoJ NIRP/YCC exit to the March MPM, 12 March 2024). We think the case for March is strengthened by 1) recent improvement in capex data, which paint a better picture for domestic demand; 2) aggressive union wage demands, which raise the likelihood that FY24 Shunto wage hikes will beat last year's by a significant margin (see see Shunto update: Raise base-up estimate to 3.5% on strong union demands); and 3) recent media reports suggesting discussion over the post-YCC framework are in very advanced stages (Exhibit 1).

Global Rates & Currencies Research
MLI (UK)

Izumi Devalier
Japan and Asia Economist
BofAS Japan
+81 3 6225 6257
izumi.devalier@bofa.com

Shusuke Yamada, CFA
FX/Rates Strategist
BofAS Japan
+81 3 6225 8515
shusuke.yamada@bofa.com

Takayasu Kudo
Japan and Asia Economist
BofAS Japan
+81 3 6225 8592
takayasu.kudo@bofa.com

Tomonobu Yamashita
Rates Strategist
BofAS Japan
+81 3 6225 7950
tomonobu.yamashita@bofa.com

Adarsh Sinha
FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 7155
adarsh.sinha@bofa.com

Janice Xue
Emerging Asia FI/FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 8587
janice.xue@bofa.com

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Exhibit 1: Recent BoJ-related reports in the media

Reporting around the upcoming 19 Mar MPM to intensify further around the blackout period, starting 14 March

Date (JST)	Outlet	Headline
6 Mar	Jiji	BoJ board member to express opinion on exiting NIRP in March--first rate hike in 17 years if decided
7 Mar	Bloomberg	Some Japan Government Officials Support Near-Term BOJ Rate Hike
8 Mar	Reuters	BOJ's growing confidence in prices, wages shifts focus to March meeting
8 Mar	Jiji	BoJ considering scrapping YCC, introduce new "quantitative" monetary policy framework showing outlook for JGB purchases to facilitate smooth normalization from easing
11 Mar	Jiji	Support for March NIRP exit spreading within BoJ as FY24 Shunto likely to exceed last year's
12 Mar	Bloomberg	BOJ Is Said to Mull March Hike With Outcome Too Close to Call
12 Mar	Reuters	BOJ to offer guidance on bond buying pace upon ending YCC - sources
13 Mar	Kyodo	BoJ to discuss raising interest rates in MPM from 18th; virtuous cycle of wages and prices

Source: BofA Global Research, various media outlets; English translation of the titles of the 6 Mar, 8 Mar and 11 Mar Jiji and 13 Mar Kyodo articles are BofA's own, since an English version of the original Japanese is not available

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The strongest argument for waiting until April is that the extra month gives the BoJ access to several pieces of high-quality data, including the 1) 1Q BoJ Tankan, 2) FY24 Shunto data up to Rengo's 4th response round; 3) feedback from the quarterly BoJ branch mangers' meeting. We do not think these datapoints would affect the BoJ's decision to exit NIRP/YCC by the end of the spring per se. Rather, they are important because they can be used to bolster the central bank's case to move off emergency policy settings.

BoJ to send strong signal for April move, even if they pass on March

Despite the markets hand-wringing over March vs. April, we think the most important takeaway is that the BoJ has effectively made up its mind to move by the end of the spring.

Thus, even if the BoJ ends up holding in March, we think it is highly unlikely that it will be a "headfake," the likes of which we saw after the June, September, and December 2023 policy meetings. Instead, the BoJ is likely to send a much more explicit signal that it is thinking of moving at its next policy meeting, on 25-26 April.

We think this could take the form of Chairman's instructions to the Bank's staff to explore options for changes to the central bank's policy framework in the policy statement or further signals in Governor Ueda's post-MPM press conference.

Expected details of the BoJ's post-QQME+YCC framework

Exhibit 2 summarizes our best guess for the potential revisions to the BoJ's current framework at the time of its next move, either in March or April.

As signaled earlier in Governor Ueda's post-Jan MPM press conference and the January MPM Summary of opinions, we think policy changes will not to be limited to an exit from NIRP.

Rather, we think the BoJ's decision to declare its 2% price stability target "in sight" and exit NIRP will be accompanied by a fairly comprehensive overhaul of the BoJ's current easing framework, including:

1) Removal of YCC and transition back to a simple policy target focused on the uncollateralized overnight call rate (to be initially set in a range of 0-0.1%);

2) Formal end to risk asset purchases, particularly equities and J-REITs;

3) Removal of the 2% inflation overshooting commitment

If we are correct, the changes would bring the BoJ statement much closer to the way it looked before the introduction of Quantitative and Qualitative Monetary Easing (QQME), in April 2013.

As mentioned earlier, one of the lingering uncertainties related to the post-YCC framework was the way in which the BoJ would communicate its purchase pace for JGBs. But as discussed above, the aforementioned Jiji and Reuters reports strongly suggest that the BoJ would be transitioning to a "quantitative" guideline focused on monthly flow JGB purchase amounts.

The guideline is likely to be initially set at the current pace of JPY6trn/month and unlikely to be reduced for the time being. This is consistent with our long-standing base case that the BoJ would not start quantitative tightening (QT) until 2025 (for a detailed discussion of the post-YCC framework for JGB purchases, please see: YCC removal could be dovish if BoJ keeps current monthly JGB purchases, 12 March 2024).

Exhibit 2: The BoJ's current policy settings and our expectations for changes under the "new" policy framework
We expect the BoJ to overhaul its policy framework at the time of its NIRP exit

	Existing framework: QQME+YCC	New policy framework
(1) Yield Curve Control		
Guideline for market operations		
- Short-term policy interest rate	IOER on the Policy-Rate Balances: -0.1%	Uncollateralized Overnight Call Rate: 0～0.1%
Ref: Complementary deposit facility	3 tiers of IOER at -0.1%/0.0%/+0.1%	IOER to be consolidated to single tier of +0.1%
- Long-term interest rate	10-year JGB yields: around 0%	removed
Conduct of yield curve control		
- Upper bound for 10-year JGB yields	1.0%	Removed (YCC abolished)
- Nimble responses	Increasing the amount of JGB purchases and conducting fixed-rate purchase operations and the Funds-Supplying Operations against Pooled Collateral	Increasing the amount of JGB purchases if needed (to be noted under guidelines for JGB purchases in (2) below)
(2) Guidelines for asset purchases		
- JGBs	-	Continue current pace of monthly JGB purchases of ~¥6tn for the time being
- ETF	Purchase as necessary with upper limits of about ¥12tn on annual paces of increase in the amounts outstanding	Maintain the amount outstanding of around ¥37tn
- J-REIT	Purchase as necessary with upper limits of about ¥180bn on annual paces of increase in the amounts outstanding	Maintain the amount outstanding of around ¥650bn
- CP	Maintain the amount outstanding of ¥2tn	no change
- Corporate bonds	Purchase at about the same pace as pre-COVID, so that the amount outstanding will gradually return to ¥3tn.	no change
(3) Forward guidance		
- QQME+YCC framework	The Bank will continue with QQME+YCC, as long as it is necessary for maintaining the target in a stable manner	removed
- Monetary base commitment	The Bank will continue expanding the monetary base until the YoY rate of increase in the observed CPI (ex fresh food) exceeds 2% and stays above the target in a stable manner	removed
- Additional easing if necessary	The Bank will continue to maintain the stability of financing, mainly of firms, and financial markets, and will not hesitate to take additional easing measures if necessary	no change
Other	-	Governor Ueda to emphasize, i.e. in post-MPM press conference, the gradualism of potential, future hikes, reiterating that "it is hard to imagine a path in which [the BoJ] keep raising the interest rate rapidly [following the exit from NIRP]."

Source: BofA Global Research, BoJ

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What kind of forward guidance can we expect?

BoJ wary of "forward guidance trap"

Perhaps the remaining source of uncertainty is whether the BoJ will offer new rates forward guidance that pre-commits the central bank to an extremely gradual hiking pace.

We think that the BoJ would be reluctant to do so, given the high degree of uncertainty around the outlook for the Japanese economy and inflation, on both the upside and downside.

For example, speaking in a press conference following his 6 December speech in Oita, deputy governor Ryozo Himino mentioned MIT professor Athanasios Orphanides' presentation at the May 2023 BoJ IMES conference.

In the presentation, Professor Orphanides discussed how the DM central banks, including the Fed and ECB, fell into a "forward guidance trap" as adherence to strict forward guidance on policy rates delayed lift-off, fueling high inflation.

Deputy governor Himino agreed with the argument that, while it's important for central banks to explain the rationale behind their policy decisions, it's problematic to pre-commit to a specific sequence of actions.

Gov Ueda likely to stress gradualism in his press conference remarks

Having said this, the BoJ is likely wary of being perceived as hawkish and stoking unwanted speculation over an early and aggressive path for additional hikes. As such, we expect Governor Ueda use his post-MPM press conference to re-iterate recent comments hinting at gradualism[1], and the expectation that monetary conditions will remain easy, even after the exit from NIRP.

We continue to see cautious hikes, to 0.25% in October, and 0.5% in April 2025

As for our outlook for the BoJ's rate hike path: for now, we keep unchanged our call that the BoJ's exit from NIRP will be followed by additional hikes, to 0.25% in 4Q CY24 (October) and 0.5% in 2Q CY25 (April).

In our view, further hawkish repricing of the BoJ hiking path would require evidence of a robust recovery in sentiment and consumer spending following spring wage hikes, which we will not be able to assess for at least a few more months.

What to watch in the days ahead

Ahead of the BoJ's 19 March policy decision, markets will likely remain sensitive to BoJ-related headlines.

On the data front, the last big piece before next Tuesday's MPM is Rengo's announcement of initial estimates of FY24 average base pay hikes, which will be published after the close on Friday, 15 March.

Markets will also be on guard for further BoJ "leaks" by the media outlets. In particular, the Nikkei Shimbun's prognosis for the March MPM will be closely watched, given the paper's track record of flagging policy changes in the past.

- Izumi Devalier & Takayasu Kudo, Economists

Market implications

As we head into the BoJ MPM next week, we summarize key points of our view on the yen markets. We see four potential scenarios depending on the decision on NIRP/YCC and tone of accompanying BoJ guidance (for our view on each market, see below):

- **On hold, but with strong signal for NIRP/YCC exit at the 26 April MPM**: The yen markets have priced in a removal of NIRP and YCC as the possibility has been telegraphed by media. 2yr JGB yield is traded around 0.2%, which suggests the market penciled in the NIRP end and shift to a single-tier IOER structure. The BoJ not moving next week would lead to positional unwinding, leading to higher USD/JPY (148-150) and lower JGB yields (0.7% for 10yr JGBs) but expectations for April could limit the move.

- **NIRP/YCC exit, with very dovish guidance:** This would see the BoJ exit NIRP/YCC and commit to strong forward guidance (i.e. in the policy statement) that front-end rates would stay on hold for the foreseeable future. On JGB purchases, the governor may stress that he did not expect purchase amounts to be cut (from the reported, JPY6trn/month pace) for the foreseeable future (i.e. a year). In this case, USD/JPY could rise to 150 and test the cyclical high of 152 in coming weeks, raising the FX intervention risk.

[1] For example, Governor Ueda may repeat the comments made by himself and other BoJ officials such as deputy Governor Uchida and board member Takata that, given the central bank's current outlook for the economy and prices, "it is hard to imagine a path in which it would then keep raising the interest rate rapidly."

- **NIRP/YCC exit, with moderately dovish/balanced guidance (BofA base case):** In this scenario, Governor Ueda may use his post-MPM press conference to reiterate recent remarks that, under the BoJ's current baseline view, he did not expect the BoJ to hike rates rapidly. However, the governor would also stress that the outlook for policy will be data dependent, retaining flexibility for future policy actions. On JGB purchases, the governor may stress that the Bank did not expect buying amounts to be cut in the near-term, but that the decision would be reviewed at every policy meeting.

- **NIRP/YCC exit, with somewhat hawkish guidance:** This scenario would see the BoJ acknowledging that recent upside surprises in the data (i.e. FY24 Shunto wage hikes) meant that the upside risk to underlying inflation was slightly higher than the central bank thought previously. On JGB purchases, the governor might hint at the possibility that purchases could be cut, or that the reported JPY6tn/month initial guideline for flow JGB purchases would be revised flexibly based on market conditions. In this case, USD/JPY could fall to 144-146 range and the 10yr JGB yield could rise to 0.85%.

Rates: Excessive JGB purchases likely to continue

Since the publication of the *Jiji* article, the market sees enhanced risk for the BoJ's NIRP and YCC removal at the March MPM. On the other hand, the BoJ's policy revisions are expected to be gradual, so that they do not lead to a sharp rise in JGB yields. According to the *Jiji* article, the BoJ is likely to buy around ¥6tn in JGBs per month, while the BoJ has already reduced its outright purchases of JGBs to ¥5.9tn, bringing its monthly purchase amount generally in line with future scheduled redemptions[2]. In other words, the BoJ may not start a de facto QT in the near term.

Hence, in our view, room for a rise in the 10yr JGB yield will be limited even if the BoJ retreats from its inflation-overshooting commitment when exiting YCC. On the other hand, there is a risk that the BoJ reduces purchases of 5-10yr JGBs and increases purchases of 1-3yr and/or 3-5yr JGBs, which would enable the BoJ to keep the total size in JGB purchases unchanged. However, BoJ would buy about 58% of 1-3yr JGBs and about 74% of 3-5yr JGBs of new issuance from April if the BoJ keeps the current size of bond-buying operations[3]. Thus, supply/demand over medium term is expected to be tight, and the reduction in JGB purchases of 5-10yr and increase in JGB purchases of medium-terms would likely be limited[4]. We expect the 10yr JGB yield to be traded between 0.75%-0.80% if the BoJ delivers policy revisions as *Jiji* reported (spot: 0.763%).

We think the risk to our views on yen rates is skewed to the upside. What *Jiji* reported on bond-buying operations seems very dovish even though the BoJ is expected to overhaul its asset-purchase program at the March MPM. BoJ governor Ueda may comment about likely QT at the press conference, and the market could price in a de facto start in QT.

- Tomonobu Yamashita, Rates Strategist

USD/JPY: buy the dip

We advise investors to look at the detail of potential policy changes. The market's reaction to a potential removal of YCC, NIRP, and overshooting commitment may be initially hawkish. However, if the BoJ communicates to the market that it would maintain the pace of bond buying in case of flow target policy, the JGB market would likely stabilize as it expects stable bond buying by the BoJ in the near term (see: Japan

[2] Scheduled monthly redemptions of the BoJ's current holdings of JGBs will average about ¥5.9tn in 2024.
[3] 73% for 5-10yr JGBs
[4] One of the opinions expressed at the December 2023 BoJ workshop conducting a "Broad-Perspective Review Of Monetary Policy" was that BoJ JGB holdings in excess of 70% of outstanding issuance reduces market trading volume.

Viewpoint: YCC removal not hawkish if BoJ keeps current monthly JGB purchases 13 March 2024).

If it scraps YCC and establishes a new guideline for flow JGB purchases at JPY6tn/month, as the *Jiji* report implies, USD/JPY's decline from here would likely be limited. If Ueda sounds constructive on additional hikes and balance sheet reduction in the near future in his press conference, USD/JPY correction could extend through 145. If the BoJ unexpectedly stays on hold next week or strikes dovish guidance on future hikes and QT, USD/JPY could resume its uptrend, which increases the risk of FX intervention if it approaches 152.

- Shusuke Yamada, FX/Rates Strategist

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- **Global Rates Year Ahead 2024 –** Cloudy with a chance of landing, 19 Nov 2023
- **G10 FX Year Ahead -** The year of the landing, 20 Nov 2023
- Ahead of a busy week, **Liquid Cross Border Flows**, 4 Mar 2024

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Global FX Weekly: The June target 08 March 2024

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Research Analysts

US

Ralph Axel
Rates Strategist
BofAS
+1 646 855 6226
ralph.axel@bofa.com

Paul Ciana, CMT
Technical Strategist
BofAS
+1 646 855 6007
paul.ciana@bofa.com

John Shin
FX Strategist
BofAS
+1 646 855 9342
joong.s.shin@bofa.com

Vadim Iaralov
FX Strategist
BofAS
+1 646 855 8732
vadim.iaralov@bofa.com

Mark Cabana, CFA
Rates Strategist
BofAS
+1 646 855 9591
mark.cabana@bofa.com

Bruno Braizinha, CFA
Rates Strategist
BofAS
+1 646 855 8949
bruno.braizinha@bofa.com

Meghan Swiber, CFA
Rates Strategist
BofAS
+1 646 855 9877
meghan.swiber@bofa.com

Europe

Ralf Preusser, CFA
Rates Strategist
MLI (UK)
+44 20 7995 7331
ralf.preusser@bofa.com

Ruben Segura-Cayuela
Europe Economist
BofA Europe (Madrid)
+34 91 514 3053
ruben.segura-cayuela@bofa.com

Mark Capleton
Rates Strategist
MLI (UK)
+44 20 7995 6118
mark.capleton@bofa.com

Athanasios Vamvakidis
FX Strategist
MLI (UK)
+44 020 7995 0279
athanasios.vamvakidis@bofa.com

Sphia Salim
Rates Strategist
MLI (UK)
+44 20 7996 2227
sphia.salim@bofa.com

Kamal Sharma
FX Strategist
MLI (UK)
+44 20 7996 4855
ksharma32@bofa.com

Ronald Man
Rates Strategist
MLI (UK)
+44 20 7995 1143
ronald.man@bofa.com

Michalis Rousakis
FX Strategist
MLI (UK)
+44 20 7995 0336
michalis.rousakis@bofa.com

Pac Rim

Adarsh Sinha
FX Strategist
Merrill Lynch (Hong Kong)
+852 3508 7155
adarsh.sinha@bofa.com

Janice Xue
Rates Strategist
Merrill Lynch (Hong Kong)
+852 3508 8587
janice.xue@bofa.com

Shusuke Yamada, CFA
FX/Rates Strategist
BofAS Japan
+81 3 6225 8515
shusuke.yamada@bofa.com