

Japan Watch

BoJ review: Governor gone, challenges remain

A dovish coda

The Bank of Japan BoJ policy board kept all key policy settings unchanged today, including the +/-50bp band around the zero% 10yr JGB target. The decision was unanimous. Though we and the analyst consensus had been expecting this outcome, some market participants were on guard for a final “surprise” policy move from outgoing BoJ governor Haruhiko Kuroda, ahead of the leadership transition in April.

In the end, the BoJ gave no hints that it was contemplating a change in the direction of policy. The central bank also left intact the easing bias in its forward guidance, stating that “it would not hesitate to take additional easing measures if necessary” and that it “expects short- and long-term policy interest rates to remain at their present or lower levels.” It also kept its assessment of the economic and inflation outlook unchanged from January (see Exhibit 4 in the Appendix).

Focus turns to policy changes under new BoJ leadership

While the BoJ may have disappointed investors who were looking for Governor Kuroda to exit with a bang, today’s non-action is unlikely to quell expectations of near-term policy change among market participants: with Japan’s parliament officially approving incoming governor Kazuo Ueda’s nomination today, the outgoing governor is seen as a lame duck.

And while incoming governor Ueda established a fairly high bar for policy normalization in his Diet remarks, stressing that it would require “further improvement in the underlying inflation outlook,” he set a lower bar for changes to yield curve control (YCC), stating that [even if the underlying inflation outlook doesn’t improve,] “the BoJ may need to consider a more sustainable format of monetary easing, taking into account the side effects [caused by current YCC policy].” He also acknowledged the possibility that such adjustments may need to be delivered by surprise.

Indeed, we think flexibilizing YCC will be the highest priority for the BoJ under the new governor and think another adjustment to the policy settings for long-end rates control is likely by the end of July, with the 16 June MPM being our base case (see [BoJ preview: The Last Dance, 7 March 2023](#)). In terms of the form of adjustment, we are leaning towards a potential shortening of the long-rate target to 5yrs (from the current 10yrs), with the zero% +/-50bp target and band left intact. But we do not have a super-strong conviction, and also see another widening of the 10yr target permissible trading range to +/-100bp as an option.

Why not April?

Timing wise, while we certainly wouldn’t rule out the possibility that the new Governor moves in the first scheduled MPM under his watch, ending 28 April, we see a lower probability due to:

1) the fact that it comes right ahead of the long Golden Week holidays;

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- 2) incoming governor Ueda's Diet hearing remarks that he wanted to have "careful discussions with the board" over possible policy changes;
- 3) the risk that a change at the new BoJ leadership's very first meeting — even if warranted — creates the impression that policy is moving on a pre-set agenda, and...
- 4) lack of sufficient data to make a strong argument that the economy can withstand the likely rise in interest rates following the loosening of YCC — several rounds of responses from the FY23 *Shunto* negotiations will be available by the 28 April meeting but the impact on macro wages will be clearer by June/July.

Having said this, we see the 28 April MPM as very much "live" and — though we see the probability as low — we also wouldn't rule out the possibility that the Ueda BoJ announces the changes at an emergency MPM between the April and June meetings, depending on the market backdrop.

On the other hand, we assign a very low probability to other "tail risk" scenarios, such as an emergency MPM before the 28 April MPM. We also do not expect a "last minute"/surprise early resignation announcement from Governor Kuroda to align terms of the BoJ governor and his deputies, since that is likely to cause unnecessary speculation and volatility in the markets.

Finally, while we think further YCC adjustments are a matter of time and will be tackled fairly early after the new governor assumes office, we expect the Ueda BoJ in general to proceed cautiously and gradually with policy normalization in order to avoid damaging the nascent recovery in Japan's economy and underlying inflation.

Thus, at this stage, we do not expect the BoJ to end negative interest rate policy (NIRP) or abandon the overall YCC framework until mid-2024 or later.

What to watch in the weeks ahead

In terms of potentially market-moving events in the weeks ahead, the immediate focus will likely be on headlines around the *Shunto* spring wage negotiations, with the 15 March announcement by major unions likely to be closely watched (the actual release of tabulated first-round wage responses by Japan's umbrella union Rengo will not be out until 17 March) (see Exhibit 3 in the Appendix for a calendar of key BoJ-related events and data releases). A strong result could stoke market speculation of early YCC changes.

Following this, the focus will turn to the release of the Summary of Opinions for the 9-10 March MPM (out 20 March) and inaugural press conference by the deputy governors. This will be followed by new BoJ governor Kazuo Ueda's inaugural press conference (likely 10 April).

We do not think Ueda's remarks will veer substantially from his recent Diet statements, but we will be paying close attention to his comments on the economy/inflation, in light of the early *Shunto* results.

- Izumi Devalier and Takayasu Kudo, Japan Economists

Rates: Kuroda BoJ leaves deterioration in JGB market functioning unaddressed

The BoJ left all policies unchanged at its March Monetary Policy Meeting (MPM), and the Financial Markets Department did not announce any changes to rules on the security lending facility. In other words, even though some turmoil arose in the delivery of JB367 and JB368, the BoJ did not deal with the deterioration in bond market functions.

As of 28 February, the amount of JB369 outstanding in the market, excluding the BoJ's holdings, was nearly ¥4tn. However, by 9th March, the BoJ purchased ¥3.3tn of the 10yr on-the-run issue through fixed-rate purchase operations, and assuming that all of these were JB369, the market balance of this issue must have declined to about ¥660bn. As with JB367 and JB368, the BoJ's holdings of JB369 might exceed 100% of issuance

before the April MPM. Although the Financial Markets Department might fine tune its operations in the near term, the bond market's functionality will not fundamentally improve unless yield curve control (YCC) is abolished.

Yen rates fell across the curve in response to the BoJ's decision to keep its policy unchanged, but the market's expectations of policy revision have not entirely fallen away. Based on the assumption that arbitrage will work, the fair price of JGB futures (June contract) calculated from the price of the CTD issue is about ¥146.4, while the actual price of JGB futures for the June contract is still below that, indicating that there are lingering expectations of a policy revision under new BoJ Governor Kazuo Ueda. We do not believe these expectations will dissipate easily, and we expect another YCC challenge to arise before the MPM on 27-28 April.

- Tomonobu Yamashita, Rates Strategist

FX: waiting for Ueda

The result of today's MPM was in line with expectations. The market is likely to focus on the April MPM when Ueda will lead the discussion. Our view is that the BoJ's policy tweak on YCC without a hawkish pivot would be negative for JPY as it reduces policy uncertainty and market volatility and would promote yen-carry trades (see: [BoJ's one-off policy tweaks may unleash yen-carry trade 27 February 2023](#)). For now, we think the market would continue to speculate over a number of scenarios that could come out from an Ueda-led BoJ.

- Shusuke Yamada, FX/Rates Strategist

Appendix

Exhibit 1: Schedule of BoJ monetary policy meetings and key releases in 2023

2023

Date of MPM	Outlook Report	Summary of opinions	MPM Minutes
17 Jan (Tue)	18 Jan (Wed)	26 Jan (Thu)	15 Mar (Wed)
9 Mar (Thu)	10 Mar (Fri)	20 Mar (Mon)	8 May (Mon)
27 Apr (Thu)	28 Apr (Fri)	11 May (Thu)	21 Jun (Wed)
15 Jun (Thu)	16 Jun (Fri)	26 Jun (Mon)	2 Aug (Wed)
27 Jul (Thu)	28 Jul (Fri)	7 Aug (Mon)	27 Sep (Wed)
21 Sep (Thu)	22 Sep (Fri)	2 Oct (Mon)	6 Nov (Mon)
30 Oct (Mon)	31 Oct (Tue)	9 Nov (Thu)	22 Dec (Fri)
18 Dec (Mon)	19 Dec (Tue)	27 Dec (Wed)	TBA

Source: BofA Global Research, Bank of Japan

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Exhibit 2: G3 central bank decision calendar

2023

2023												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
BoJ	18		10	28		16	28		22	31		19
	(Wed)		(Fri)	(Fri)		(Fri)	(Fri)		(Fri)	(Tue)		(Tue)
Fed		01	22		03	14	26		20		01	13
		(Wed)	(Wed)		(Wed)	(Wed)	(Wed)		(Wed)		(Wed)	(Wed)
		[T+1]	[T+1]		[T+1]	[T+1]	[T+1]		[T+1]		[T+1]	[T+1]
ECB		02	16	05		15	27		14	26		14
		(Thu)	(Thu)	(Wed)		(Thu)	(Thu)		(Thu)	(Thu)		(Thu)

Source: BofA Global Research, Bloomberg Note: Blue shaded dates represent decisions associated with Summary of Economic Projections (SEP) for the FOMC, Staff projections for the ECB, and Outlook Report for the BoJ.

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Exhibit 3: Calendar of BoJ-related events through July 2023

We expect the new BoJ leadership to deliver adjustments to YCC by July 2023

Date	Event
10 Mar	March MPM (last meeting for Governor Kuroda and deputy governors)
15 Mar	Announcement of <i>Shunto</i> wage settlements from the largest unions
17 Mar	Results of FY23 <i>Shunto</i> spring wage negotiations 1st response round published by Rengo
19 Mar	End of term for deputy governors Amamiya and Wakatabe
20 Mar	Summary of Opinions for the 9-10 Mar MPM
20 Mar?	Inaugural press conference of new deputy governors
31 Mar	Mar Tokyo CPI
8 Apr	End of term for Governor Kuroda
9 Apr	New BoJ governor's term starts
9 Apr	Unified local elections (first half)
10 Apr?	Inaugural press conference of the new governor
23 Apr	Unified local elections (first half)
28 Apr	April MPM, Outlook Report (new BoJ leadership's first MPM); Apr Tokyo CPI
Apr 29 - May 5	Golden Week Holidays (Apr 29 & May 3-5 are public holidays)
8 May	Release of the 9-10 March MPM minutes
11 May	Summary of Opinions for the 27-28 April MPM
19 May	G7 Summit (Hiroshima) (PM Kishida's hometown)
26 May	May Tokyo CPI
6 Jun	Apr Labor Cash Earnings
16 Jun	June MPM
21 Jun	Release of the 27-28 April MPM minutes
26 Jun	Summary of Opinions for the 15-16 Jun MPM
30 Jun	June Tokyo CPI
7 Jul	May Labor Cash Earnings
28 Jul	July MPM, Outlook Report; Jul Tokyo CPI

Source: BofA Global Research

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Exhibit 4: Summary of BoJ monetary policy statement (March 2023)

Key changes from January '23 MPM in red

10 March MPM	
Overall assessment of Japan's economy	Has picked up as the resumption of economic activity has progressed while public health has been protected from COVID-19, despite being affected by factors such as high commodity prices
Exports	Have been affected by the developments in overseas and more or less flat have increased as a trend , supported by a waning of the effects of supply-side constraints
Business investment	Has increased moderately
Private consumption	Has increased moderately, despite being affected by COVID-19
Housing investment	Has been relatively weak
Public investment	Has been more or less flat
Industrial production	Have been affected by the developments in overseas and more or less flat have increased as a trend , supported by a waning of the effects of supply-side constraints
Labor market	Has improved moderately on the whole
Financial conditions	Have been accommodative on the whole, although weakness in firms' financial positions has remained in some segments
Consumer prices	Year-on-year rate of change has been at around 4 percent in the range of 3.5-4.0 percent due to rises in prices of such items as energy, food, and durable goods
Inflation expectations	have risen
Outlook for the Japanese economy	Japan's economy is likely to recover, with the impact of COVID-19 and supply-side constraints waning, although it is expected to be under downward pressure stemming from high commodity prices and slowdowns in overseas economies. Thereafter, Japan's economy is projected to continue growing, at a pace above its potential growth rate as a virtuous cycle from income to spending intensifies gradually. The year-on-year rate of increase in the CPI (all items less fresh food) is likely to decelerate toward the middle of fiscal 2023 due to the effects of pushing down energy prices from the government's economic measures and to a waning of the effects of a pass-through to consumer prices of cost increases led by a rise in import prices. Thereafter, the rate of increase is projected to accelerate again moderately on the back of improvement in the output gap, rises in medium- to long-term inflation expectations and in wage growth, and a waning of the effects of the economic measures pushing down energy prices toward the middle of fiscal 2023.
Consumer prices	
Risks to the outlook	Concerning risks to the outlook, there remain extremely high uncertainties for Japan's economy, including the following: developments in overseas economic activity and prices; developments in the situation surrounding Ukraine and in commodity prices;

Exhibit 4: Summary of BoJ monetary policy statement (March 2023)

Key changes from January '23 MPM in red

10 March MPM	
	and the course of COVID-19 at home and abroad and its impact. In this situation, it is necessary to pay due attention to developments in financial and foreign exchange markets and their impact on Japan's economic activity and prices.
Conduct of monetary policy	The Bank will continue with QQE with Yield Curve Control, aiming to achieve the price stability target of 2 percent, as long as it is necessary for maintaining that target in a stable manner.
Overshoot commitment	It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner
Future conduct of monetary policy and forward guidance for rates	For the time being, the Bank will closely monitor the impact of COVID-19 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.

Source: Bank of Japan, BofA Global Research

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