MNI BoJ Preview - March 2023

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Central Bank Watch - Bank of Japan

March 08, 2023

MNI Bank of Japan Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Tokyo CPI	% y/y	3.4	3.7	↓	2.9	↑					1.13
Tokyo CPI - Ex Fresh Food	% y/y	3.3	3.6	↓	2.6	↑					0.04
PPI	% y/y	9.5	9.7	↓	9.3	↑					-0.70
Inflation Swap 5y5y	%	0.90	0.95	↓	0.80	↑					0.94
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Industrial Production	% m/m	-4.6	-3.2	↓	0.8	↓					-1.12
Tertiary Industry Index	% m/m	-0.4	-0.1	↓	-0.4	→					-0.87
Core Machinery Oders	% m/m	1.6	-4.6	↑	0.9	↑					0.56
Exports	% y/y	3.5	25.3	↓	19.0	↓					-1.91
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M2 Money Supply	% y/y	2.7	3.1	↓	3.4	↓					-0.87
Bank Lending	% y/y	3.3	2.7	↑	1.9	↑					1.39
Loans Outstanding (Bus)	% y/y	5.55	4.86	↑	3.35	↑					1.27
Housing Starts	% y/y	6.6	-1.8	↑	-5.4	↑					1.69
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	6.3	4.4	↑	2.4	↑					1.11
Household Spending	% y/y	-1.3	2.3	↓	3.5	↓					-1.19
Unemployment Rate	%	2.4	2.6	↓	2.6	↓					-1.85
Ave Monthly Cash Earnings	% y/y	0.8	1.4	↓	1.3	↓					-1.14
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Nikkei 225	Index	28444	27969	↑	28092	↑					-0.31
Japanese 10-Year Yield	%	0.51	0.25	↑	0.23	↑					1.41
Japan Yield Curve (2s-10s)	bps	54.1	27.6	↑	30.8	↑					1.64
JPY TWI	Index	94.61	94.44	↑	95.19	↓					-0.02

Source: MNI, Bloomberg

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MNI POV (Point Of View): End Of An Era, But Not Of YCC

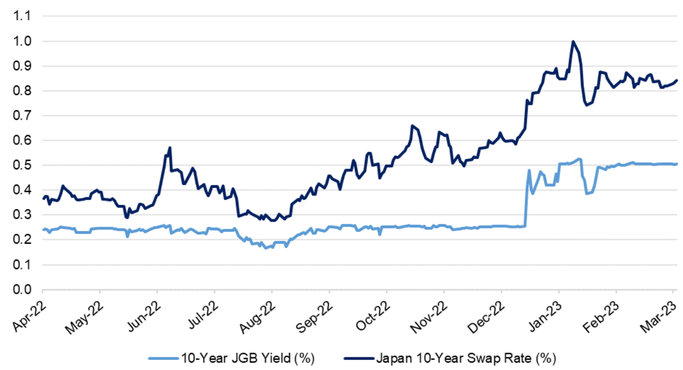
A clear consensus looks for no change in BoJ policy settings come the end of outgoing Governor Kuroda's final policy meeting. Only 3 of the 49 economists surveyed by Bloomberg look for a hawkish policy move this time out. We side with the majority on this. However, the Bank's recent propensity to shock (see the surprise widening of the YCC band back in December) means that this view is held with varying degrees of conviction.

The argument for a widening of the BoJ's YCC band centres on the continued test of the Bank's will when it comes to its existing YCC settings, alongside a desire to promote a smooth handover to BoJ Governor-in-waiting Ueda.

On the former, we note the aggression in the market's challenge of the BoJ's policy settings has moderated, with less forceful moves through the BoJ's YCC cap observed in recent weeks (despite a near enough constant test of the Bank's tolerance), while there has also been a moderation in the 10-Year swap spread and outright swap rates from their extremes. One other matter to be aware of is that the latest BoJ survey indicated that JGB market conditions (the supposed focal point of the YCC tweak) have deteriorated since the Bank's December policy move and January adjustment to the pooled collateral funding operations (which aids YCC maintenance), although various board members have stressed the need for time when it comes to assessing the efficacy of those moves.

Re: promoting a smooth transition for Ueda, this assumes that there wouldn't be a swift challenge of the BoJ's new YCC settings, such a move cannot be ruled out if, for instance, we saw a 25bp widening at each end of the band.

Fig. 1: 10-Year JGB Yields Vs. Japan 10-Year Swap Rate



We think that Kuroda will be happy to leave policy settings as they are come the end of the final meeting of his tenure, given the already forced YCC adjustment at the tail end of last year and the above matters. Furthermore, headline Tokyo CPI and CPI excluding fresh food pulled back from cycle highs in February, although that was a product of government subsidies surrounding energy (the excluding fresh food and energy measure registered a fresh cycle high). Incoming Governor Ueda has already pointed to an inflationary peak being in the rear-view, from a chronological perspective, which would lessen the need for BoJ action on that front. Some quarters of the BoJ and government have also played down the need for a tweak to the BoJ-government accord on inflation, as well as an imminent need for policy change. Still, we should be cognisant of the fact that Ueda has flagged a preference for "surprise" decisions in some instances.

To recap, Ueda appears to hold a more moderate view on matters than his predecessor, despite coming down on the dovish side of market expectations when it came to his nomination hearings in both the upper and lower houses of parliament (indicating that current policy settings are correct, for now, when speculation surrounding a hawkish pivot alongside the leadership change was at fever pitch). Ultimately, the upcoming shunto wage negotiations will provide the next key input for the Bank's policy considerations (the subsequent round of wage negotiations for employees of smaller firms will be equally important). A large survey of labour unions has already indicated that they will ask for an average ~4.5% pay rise in the upcoming talks, the largest such increase touted since the 1990s.

Some desks have flagged the proximity to Japanese fiscal year end as an impediment to a tightening move, given the related impact on the financial accounts of major market participants. Another matter to contend with is the increased likelihood of a sharper Fed tightening cycle with a higher end point. Conversely (and relatedly), many are also aware of the risks of a global recession, which could curtail the Bank's ability to act further down the line.

The early days of Ueda's tenure will be telling (Kuroda's term officially ends on 8 April). His first policy meeting atop the central bank is scheduled for 27-28 April and that will likely be used to set the scene for short-term policy considerations, potentially including the announcement of a deeper review into the BoJ's monetary policy framework (which would be viewed as pre-cursor for the further relaxation of the Bank's ultra-loose policy settings). Over 60% of those surveyed by Bloomberg now look for a further hawkish policy tweak to be deployed come the end of the Bank's June meeting, with June itself seen as the most likely meeting for such a step within that window.

MNI BOJ WATCH: On Hold As Kuroda Era Ends; Ueda To Go Slowly

By Hiroshi Inoue

TOKYO (MNI) - Bank of Japan officials will not risk any policy changes to address ongoing bond market distortions at the last meeting under Governor Haruhiko Kuroda, though they are vigilant against the threat of bond market volatility amid the change of leadership in April, MNI understands.

Haruhiko, whose decade-long tenure comes to an end on April 8, is not expected to unveil new tweaks to yield curve control on Friday to avoid being seen as pre-empting any policy shifts under Governor-elect Kazuo Ueda. Officials say more time is needed to assess December's widening of the band around the 10-year yield target and the impact of daily open market operations.

Bank officials are concerned about the possible fall-out from policy changes such as a further widening of the 10-year yield band. They worry that widening the 10-year band to 75 basis points from 50 basis point could prompt market participants to immediately factor in the next widening, which would increase upward pressure on bond yields.

Ueda, who is set to take the helm on April 9, is not expected to take policy action at the April 27-28 meeting as he will want to avoid being viewed as rushing to normalise monetary policy. He is expected to take a cautious and gradual stance, attentive to the risk of undermining the foundation of a sustainable economic recovery.

The 71-year old critic of yield curve control has previously warned against premature rate hikes. The BOJ views YCC modifications as vastly different from abolishing negative short term rates, the symbol of Japan's easy policies. Removing the negative interest rate would be interpreted as a reversal of easy policy, possibly accelerating increases in bond yields. (See MNI POLICY: Ueda's YCC Concerns Hint At BOJ Policy Shift)

MARKET COMMUNICATION

Bank officials strongly hope Ueda will restore smooth communications with market participants left wary after Kuroda shocked the market with December's surprise widening of the 10-year yield band.

The scale of BOJ government bond purchases fell in February compared with January, indicating the BOJ has not been as pressured to cap the 10-year yield as it was after widening the band from 25bp to 50bp. It is uncertain how board members will assess the fall in required purchases, officials said.

The incoming governor will be aware of the potential damage to his credibility should his policy decisions cause an economic downturn. He is expected to sharply focus on the outlook for Japan’s economy and prices, as well as the outlook for global growth given the risk of more rate hikes and a U.S. recession.

Domestic wage developments are also viewed as being key early in his governorship. Data on the pace of wage hikes will not be available in April, meaning Ueda will have to carefully examine how they evolve at least for a quarter after he takes office.

Sell-Side Views

Bank of America: In our base case, we expect no changes to BoJ's policy settings this week

Barclays: We expect the BoJ to stand pat, postponing the decision on any further policy revisions until April, when new leaders take over. One focus will be whether there is any reference to a comprehensive policy review, as sought by one Policy Board member.

CBA: Our base case is the BoJ will leave monetary policy unchanged. We judge a 30% chance the BoJ dumps its yield curve control on the 10-Year JGB. The BoJ is looking for sustained wage increases to be confident the spike in inflation will be sustained.

Citi: We expect policy to be unchanged, including YCC. With the successors to the governorship and deputy governorships waiting in the wings, this is a lame-duck MPM where we would not expect significant changes under the old guard. Also, the BoJ will presumably be wary of sparking market volatility so close to the financial year-end.

- Some think the old guard should hand over after modifying (or abandoning) YCC. YCC abolition would clear communication issues out of the way for Governor Ueda to start afresh in building market confidence in the BoJ, given that the market currently has no faith in what the BoJ says. In our view, however, it seems better to discuss the whole picture of the current policy including YCC under the new regime.
- Based on Mr. Ueda's Diet hearings, YCC rejigging seems unlikely at the new regime's first MPM in April. We think this could happen in June, or perhaps the July MPM when the Outlook Report is updated. Our base case is July, when the results will be clear for a considerable portion of the spring wage negotiations.

Danske Bank: We still think BoJ will tweak YCC in the short-term. It is not likely to happen this week, but we were surprised last time they did it in December. Either way, we think it is a matter of time and could happen during Q2.

DBS: The Bank of Japan is expected to keep the policy rates unchanged at Governor Kuroda's last meeting this week. Recent economic data still do not support the case of BOJ tightening – Tokyo CPI inflation eased by 1ppt to 3.4% YoY in February; manufacturing PMI and industrial production contracted more than expected in Jan/Feb. We maintain the view for the BOJ to further increase the flexibility of the yield curve control policy in 2Q – widening the 10-Year yield range by 25bps to ±0.75% or shifting the 0% target to the shorter dated 5Y yield. This considers the extension of the Fed tightening cycle into 2Q, renewed selling pressure on the JPY, upward pressure on JGB yields, and continued distortion of the JGB yield curve.

Goldman Sachs: We expect the BOJ to stay on hold for three key reasons.

- First, the meeting is close to the end of the fiscal year, and as a result, we think both the government and the BOJ likely want to avoid making any adjustments to yield curve control (YCC) that could have a wide-ranging impact not only on bonds, but also on the forex and equity markets.
- Second, the March meeting will be held just before the release of the initial results of the shunto wage negotiations, making it challenging for the BOJ to change its fundamental view on wages and inflation.
- Third, Governor Kuroda has long-held view that a premature rate hike by the BOJ have delayed Japan's exit from deflation. Given the market see the widening of the 10-year yield band in December as virtually a rate increase, we think Governor Kuroda would choose to remain on hold at his final MPM.
- However, we think caution should be warranted. Kuroda's first MPM ushered in a regime shift with unprecedented easing, and he has implemented several surprises since. Market expectations that the new BOJ leadership under the government's nominee, Ueda, could amend YCC at its first MPM in April are likely to increase strongly. With this in mind, we would note the possibility of a "pass-the-baton" scenario.
- Issues surrounding market functioning will likely be a major topic of discussion at the press conference. The BOJ's widening of the YCC in December and maturity extension of funds-supplying operations against pooled collateral in January were aimed at improving bond market function. However, according to its latest bond market survey, market functioning has continued to deteriorate. In particular. That said, policy board members Nakagawa and Takata said that more time would be needed to monitor the effectiveness of YCC amendments to ease the side effects. Ueda has also made similar comments. We guess that such agreement in opinions suggests that consensus may be formed among the BOJ officials in terms of the monitoring period. As such, we expect Governor Kuroda to reiterate this comment, and to stick to the view that the benefits of persisting with YCC still outweigh the side effects.

ING: After carefully reviewing Ueda's remarks at the two-day parliamentary hearing we think that the possibility of policy review under the new governorship has decreased as he repeatedly emphasised that he is not pursuing the need to revise the joint statement with the government in 2013. However, we still believe that the possibility of delaying the request for review until after next year should remain open, as the revision can provide the BoJ with more flexibility to carry out its policy instruments.

- Meanwhile, he stressed that it is appropriate to continue with monetary easing thus we think he won't rush to make policy adjustments at his inaugural meeting in April, but will take the first step towards normalisation as early as June. By June, he will know the results of the spring salary negotiations and have enough time to monitor the impact of the December policy adjustment. But, wage pick-up and improvement in the labour market should be strong enough to convince him to make his first move.
- For the coming months the Bank of Japan will monitor how fast inflation slows and how tight labour conditions can support sustainable inflation and adjust its policy accordingly.
- It's worth noting that the outgoing BoJ governor Haruhiko Kuroda is well known for delivering surprises to the market, so he may give up the yield curve control policy without leaving it to his successor. But, we still think that Kuroda will leave the decision to the new governor by standing pat at the upcoming March meeting.

J.P.Morgan: We expect no policy change, although we think it is only a matter of time until the conditions for additional YCC change are met. The BoJ continues to face difficulty in maintaining the current YCC & market functionality, and we think another YCC tweak is almost inevitable within a few months.

- On the other hand, preparations for higher rates by domestic economic entities are steadily advancing. The BoJ's intention of not making a policy change in January seems to have been due not only to assess the impact of the December policy change on market functionality, but also to encourage domestic economic entities that had adapted to the prolonged low interest rate environment to prepare for higher rates.
- That said, there are several reasons for the BoJ not to change policy at this week's policy meeting.
- Domestic financial institutions may not want to be forced to record large unrealized losses at the fiscal year-end, and the BoJ, which has relied on domestic financial institutions' bidding for fund-supplying operations, likely will have to give some consideration to such intentions.
- The second reason is the timing of the Diet approval of the appointment of the BoJ's new leadership.
- The third reason is that this is the last policy meeting for Kuroda. We can not rule out the possibility that Kuroda will abolish the YCC and step down at the last meeting. But, if the BoJ wants to minimize market turmoil, minimizing negative impact on the economy, complete elimination may not be a priority option.
- Under these circumstances, it is natural for Kuroda to leave the decision to new leadership that will be responsible for the path to the complete abolition of the YCC.
- The BoJ appears to recognize that additional YCC tweaks are unavoidable given the persistent decline in market functionality, but it should still prefer to minimize the negative impact on domestic financial systems. The upcoming meeting schedule is somewhat inconvenient for the BoJ. The first meeting for the new Governor who will take place just before the Golden Week holidays. This may not be very convenient for domestic financial institutions. After that, no meeting is scheduled until June 15. If the BoJ prefers to adjust YCC without being exposed to market pressure from meeting to meeting then it may prefer to adjust YCC by holding an emergency meeting. Given that Ueda didn't rule out the possibility of another surprise move, we now see rising risks for the earlier YCC adjustment ahead of our expectation of the June meeting.

Mizuho: This is the final scheduled meeting before the departures of Governor Kuroda and his deputies Masayoshi Amamiya and Masazumi Wakatabe. We expect a unanimous vote to leave policy on hold. Market attention has already shifted to possible changes under the incoming leadership group. This, and the approaching fiscal year-end for many corporations, suggests the board will not make any unexpected policy changes.

Morgan Stanley: We expect the BoJ to remain on hold at the final meeting under Governor Kuroda. While we cannot rule out the risk of a surprise YCC tweak to improve market functionality, our subjective probability for this risk scenario is roughly 20% at the March meeting.

MUFG: Among JGB market participants, speculation of a widening of the target range for the 10-year JGB yield to ±0.75% or other changes to YCC has diminished but has not disappeared entirely. We expect the Bank will decide to leave the current easing framework and market operation guidelines in place and forgo further changes to YCC.

SEB: Although expectations are rising for a policy change from the Bank of Japan, it is too early at this meeting. However, market seem to be positioned for possible surprises.

Scotiabank: No policy changes are expected when the Bank of Japan's latest decision arrives on Friday. It may matter only for sentimental reasons as this will be Governor Kuroda's final meeting at the helm.

- It is very unlikely that Kuroda will embrace change in his final meeting which is likely to be of more ceremonial significance than anything else as potential changes are likely to be left to his successor.
- A holding pattern is likely in place at least until Spring wage negotiations with unions have been completed and Governor-designate Ueda perhaps launches a policy review. For now, Ueda's confirmation testimony on February 24th brought guidance on inflation by saying "This should be the peak for now" and that more time was needed to durably hit 2% through broader forces than cost-push influences like the lagging effects of yen depreciation and oil prices on inflation. Recall that BoJ staff research has shown that yen depreciation and higher oil prices have lagging but transitory effects on inflation that are likely to wane this year into next. Ueda also leaned against any need to raise interest rates barring surprising developments that achieve 2% inflation for longer.

Societe Generale: We expect the BoJ to maintain its main monetary policy settings. The BoJ is likely to want to see the results of this year's spring wage negotiations. Moreover, as the March meeting is just before the end of the fiscal year, it is likely that the BoJ will be cautious about increasing volatility in the financial markets. Given this situation, the BoJ is extremely unlikely to change its monetary policy at the upcoming monetary policy meeting.

- The BoJ is also likely to keep policy unchanged in April, at the first meeting under the governor nominee, Ueda. The base pay rise is unlikely to exceed 2% in the spring wage negotiations. In addition, given the BoJ's review in March 2021, it will be difficult for the BoJ to widen the range beyond ±75bp at the April meeting in order to neutralise the impact on the economy. Moreover, Ueda does not prefer a modest hike in the YCC framework. However, we expect that the BoJ will widen the range of fluctuation permitted on 10-Year JGB yields from ±50bp to ±100bp in June. In addition, the BoJ could make it clear that it will hold the current range or YCC until further progress is made in prices and wages.
- We continue to expect that YCC will not be abolished in June, given the potential for shocks to the financial system and macroeconomy, as well as the scale of the public debt. The expansion to ±100bp can be justified without price developments. Regarding market functioning, the BoJ is paying attention to the rise in the 10-year corporate bond issuance yield, which has already increased to about 1%. In addition, even if the BoJ widens the range to ±100bp, the average effect since the introduction of the ultra-easy monetary policy would be maintained. Moreover, YCC sustainability is improving in the short term. Also, taking the likely possibility of a US recession into consideration, it will be difficult for the BoJ to take steps to change current monetary policy next year. We do not expect to shift the 10-year yield target to a shorter maturity.

TD Securities: It is unlikely that the BoJ will rock the boat at this meeting even as CPI inflation hit a 41-year high. Governor Kuroda at his last meeting will likely keep policy unchanged. We think the BoJ could shift the top end of the YCC band again in the months ahead, potentially as early as April.

UBS: We expect no material policy change. We do not deny the possibility of YCC adjustment given the surprise widening in December. Since then, bond market function has continued to deteriorate. However, we think the hurdle to widen the band (or any adjustment that raises 10-Year yields) is high as fiscal year end is approaching and it is hard to argue that such move is not tightening. We now expect the BoJ to end current policy framework, "QQE with YCC," and replace it with "Low-for-long with flexible QQE" in June or July. A big policy change in April looks too early based on the confirmation hearing from governor apparent Ueda. On the YCC, Ueda may prefer to amend it, instead of abandoning it. We think the pressure on bond markets will strengthen to an unacceptable level by then, leading him to judge that ending of current YCC is appropriate, especially with the new policy framework.

Unicredit: Debate seems to have emerged in the market about another increase in the 10-Year JGB's ceiling of 0.50% as a way to favor the transition of the office to Kazuo Ueda, whose term is to formally start on 8 April. The 10-Year JGB yield is slightly exceeding 0.50% again, and the Japanese 10-Year swap rate is back above 0.80% too. Another increase of the 0.50% limit would probably also require an increase in the policy rate, which remains at -0.10%, so that the spread between the two rates is not further enlarged. However, the BoJ is probably not ready for such a change yet. During his confirmation hearing to become the BoJ's new governor, Mr. Ueda, made it clear that he feels that monetary policy is appropriate for now.