

Bank of Japan: fight against 'deflation' is a lot harder than we think

The Bank of Japan has decided to maintain its easing policy amid growing concerns about slow growth, and is also committed to conducting fixed-rate operations, which triggers a sharp Japanese yen depreciation



Comments by Bank of Japan governor Haruhiko Kuroda have been pretty yen negative

-0.1/0.0 BoJ policy rate/ 10Y yield target

As expected

The yen is not part of the Bank of Japan's considerations

At today's meeting, the Bank of Japan (BoJ) clearly indicated that it is not ready to end its easing policy as its inflation target is still far away. According to the Monetary Policy Statement, the Bank will apply a negative interest of -0.1% and purchase a necessary amount of Japanese government bonds (JGBs) without setting an upper limit. A new paragraph has also been added that the Bank

will offer to purchase 10Y JGBs at 0.25% every business day through fixed-rate operations.

The BoJ reinforced its determination to support the economy and pushed back harder than expected on market speculation that the BoJ should ease upward pressure on JGB yields to protect against currency weakness. At the press conference, Governor Haruhiko Kuroda expressed some concern over the rapid pace of Japanese yen (JPY) weakness but reiterated that FX reflected the fundamentals of the economy and the weak JPY would be positive for Japan's economy as a whole.

Regarding inflation, Kuroda mentioned that although the CPI outlook is revised up to near 2%, the rise won't be sustained as it is driven by temporary cost-push factors. The CPI in April is expected to exceed 2% mainly due to the one-off telecom bill cut last year. As the BoJ is pursuing steady price gains, not a temporary hiccup, higher than 2% CPI will be downplayed by the BoJ for a while.

In our view, the BoJ's efforts to anchor the yield target around 0% will put more pressure on JPY depreciation and thus push up the cost of living. However, the BoJ made it clear today: it firmly believes that higher yields would impose bigger costs on the economy more than FX depreciation. The newly revised outlook report shows that the CPI (excluding fresh food) is expected to rise 1.9% in FY2022 but move down to 1.1% in FY2023 and 2024. With inflation below the BoJ's target of 2.0%, the BoJ's easing stance will remain for a considerable time.

Near term outlook on growth

We believe that the economy is slowly recovering after a contraction in the first quarter as the government continues to soften the social mobility restrictions. Today's monthly activity data supported our view. Industrial production in March slowed down to 0.3% month-on-month seasonally-adjusted (vs 2.0% in February) partially due to earthquake-driven factory shutdowns, while the near-term outlook for production is cloudy as global supply chain disruption worsens. However, retail sales rebounded sharply to 2.0% (vs -0.8% in February) supported by the reopening effect. Better domestic consumption and service activities will take the driver's seat for the current quarter's growth.

FX reaction: Kuroda triggers renewed JPY weakness

In advance of today's meeting, the speculation had been that the BoJ could adjust its JGB yield target to slow/stall yen depreciation. The actual outcome has probably been about as dovish/yen negative as one could reasonably expect. The BoJ has retained its 0% 10-year JGB yield target, introduced more regular JGB buying operations, and comments from Kuroda have been pretty yen negative, for example, that the weak yen is an overall positive for the economy. His remarks regarding FX market conditions have been far from aggressive as well ("short-term, excessive FX moves heighten uncertainty") which suggests conditions are still far from the disorderly levels that could trigger FX intervention.

Instead, the combination of a dovish BoJ, Japan's negative terms of trade shock on the fossil fuel surge, and a hawkish Federal Reserve all remain in place and will keep USD/JPY supported. We think USD/JPY might have to get closer to the 135 area (in a disorderly manner, e.g. [one-month USD/JPY volatility near 18/20% versus 12% today](#)) before FX intervention could be justified on market conditions. Certainly, FX intervention cannot be justified on macro fundamentals. As for [FX forecasts](#), USD/JPY is already at our forecast high of 130 and we will be minded to revise the profile higher given it looks like the dollar can stay strong/strengthen further over the next three to

six months.

The BoJ's outlook report suggests a temporary inflation rise in FY22

| % YoY | As of Jan 22 | | As of Apr 22 | |
|--------|--------------|-----|--------------|-----|
| | GDP | CPI | GDP | CPI |
| FY2021 | 2.8 | 0.0 | 2.1 | 0.1 |
| FY2022 | 3.8 | 1.1 | 2.9 | 1.9 |
| FY2023 | 1.1 | 1.1 | 1.9 | 1.1 |
| FY2024 | n/a | n/a | 1.1 | 1.5 |

Source: Bank of Japan

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