

## Bank of Japan pivot proves underwhelming for markets

The Bank of Japan has now ended decades of unconventional and aggressive monetary easing. Strong wage negotiation results played a crucial role in today's move. The market's immediate reaction was rather disappointing as the BoJ pledged to maintain accommodative monetary conditions



Bank of Japan  
Governor Kazuo Ueda

# 0.0%-0.1%

Higher than expected

Uncollateralised overnight call rate

Discontinue yield curve control policy & purchase of ETFs/J-REITs

### Summary of the BoJ's new monetary policy framework

1. The BoJ will restore the uncollateralised overnight call rate as a primary policy tool and set

- the rate in a range between 0% to 0.1% (a 7-2 majority vote).
2. A continuation of its JGB purchases with broadly the same as before – currently about six trillion yen per month (an 8-1 majority vote).
  3. The central bank will discontinue the purchase of ETFs/J-REITs while gradually reducing the amount of purchase of CP and corporate bonds. It will discontinue the purchases in about one year (a unanimous vote).
  4. The BoJ has also opted to change its terms and rates for lending facilities (a unanimous vote).

Reading through the new policy framework document, the critical factor in justifying today's policy changes was primarily down to the strong Shunto wage results. The BoJ devoted a considerable amount of space in the statement to explaining that it had gathered sufficient information on wages to make its decision. The central bank also expressed confidence that price stability was in sight. Strikingly, it also offered a fairly optimistic outlook for the economy, with private consumption in particular showing resilience. The recent weakness in production and consumption data was downplayed, with the BoJ attributing this to temporary factors caused by production disruptions in the auto sector. The central bank believes that the economy will pick up once these temporary issues are resolved.

However, with two dissenting votes, we suspect that today's decision must have been quite close. The BoJ made it clear that this is not the start of rate hikes, clearly stating that it "anticipates to maintain accommodative financial conditions for the time being." The market probably expects that the central bank would move at a glacial pace, which must be disappointing – especially with the Fed's move likely to be smaller than expected.

## Ueda's comments offer little to markets

We think the overall tone of Governor Kazuo Ueda's comments was neutral rather than dovish. Ueda admitted that the stronger-than-expected spring wage results played a large role in the decision. He reiterated that the price target is in sight and that the virtuous economic cycle has been confirmed by recent data releases.

At the same time, he also made some dovish comments. He acknowledges that the point at which inflation expectations reach 2% is still quite distant and the certainty of achieving the 2% price target is not yet certain. Ueda therefore expects the BoJ to remain accommodative until the underlying inflation trend reaches 2% – although he hasn't taken the rate hike option off the table. If the BoJ sees upside risks to inflation, this could lead to rate increases. In this sense, the April Quarterly Outlook report will be of greater interest to the market than usual.

## What to watch next

1. In the short term, it will be important to see whether or not the strong wage growth of large companies spills over to SMEs. The results of the second and third rounds of wage negotiation will be announced on 22 March and 4 April.
2. From a medium-term perspective, strong wage growth could lead to strong consumption and sustainable consumer prices. We may see the impact of the wage growth in the April/May earnings data. We also expect a big bonus payment before the Golden Week holiday.

3. In addition to wage data, consumption data should also be watched closely. After all, it is important to see whether or not the impulse of wage growth can change the consumers' spending behaviour. Temporary disruptions of car sales will distort the data through February and March, so the April data onwards should provide us with better information.
4. As for inflation, it is important to watch not only wage growth but also whether the government fuel subsidy programme will be renewed after May. Inflation staying above 2% by the end of the second quarter of this year will be key to look out for. The April Quarterly Outlook report will hint at an additional rate hike possibility.

Depending on the various outcomes of all these factors, the Bank of Japan's future policy actions may change. For now, we expect only 10bp of hikes for the year, but by the end of the second quarter we will have more data and information to judge whether the central bank can deliver another rate hike in the second half of the year. Given the strong outlook for wage growth, we believe an additional hike may become a more likely option.

## USD/JPY: More of a dollar story

USD/JPY initially rallied on what in the end was a widely expected BoJ rate hike. It has since drifted a little lower as Governor Ueda held open the door to further rate hikes. And as outlined above, there are event risks over the coming months which will prove to be yen drivers.

However, the broad-based view is that the gulf in interest rates between Japan and many other central banks in the G10 space mean that the yen will still be used as a funding currency in a low-volatility world. Our baseline view now sees USD/JPY perhaps trading around the 150-152 area as long as short-term US rates stay firm. When they turn lower over the coming months, USD/JPY should head down to the 145 area and probably close to 140 later this year when the Fed easing cycle is in full swing (we look for 125bp of Fed cuts this year).

For reference, on a recent trip to Tokyo, local accounts felt that the BoJ would not intervene to sell USD/JPY until the 155 area. At least when the BoJ next sells FX, it will now be consistent with tighter monetary policy.

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