Asset Management One

Registration No.: Director of Kanto Local Finance Bureau
(Financial Instruments Firms) No.324
Commodity Trading Advisor License #(1) No.24, the Minister of Agriculture, Forestry and Fishery & the Minister of Economy, Trade and Industry
Member of Japan Investment Advisers Association
Member of The Investment Trusts Association, Japan

Outlook and highlights of the Bank of Japan's monetary policy

25 January 2023

- Amid market speculation for a move towards normalization following the bank's expansion of the allowable range of fluctuation in long-term interest rates to ±0.5% in December last year, the Bank of Japan (BOJ) maintained current monetary policy at its January Monetary Policy Meeting.
- The BOJ's updated consumer price forecasts for FY2023-2024 remain below 2% and we believe that it will be difficult for the BOJ to take a tighter monetary policy course as the U.S. economy is likely to move into recession, and that interest rates will not be raised until after 2024, when (i) a virtuous cycle of rising prices and wages is confirmed and (ii) the U.S. economy is expected to emerge from recession.
- However, interest rates are expected to remain under upward pressure based on market expectations for policy revision ahead of the appointment of the BOJ's governor and deputy governors scheduled for March-April 2023.
- We expect that under the new governor and deputy governors, the BOJ will revise its policy towards more normalization by changing the Yield Curve Control (YCC) framework and making the price target more flexible. Realistically, these actions would be taken after (i) checking and reviewing the policy that has been implemented, and (ii) reviewing the "accord" with the Government to work together towards the 2% price stability target.

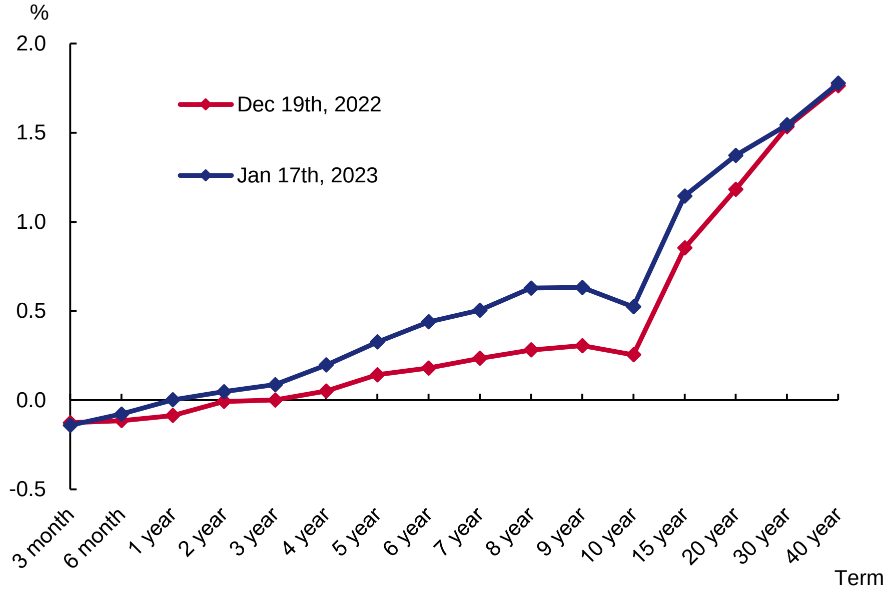
At its Monetary Policy Meeting on 17-18 January, the Bank of Japan (BOJ) decided to maintain its current monetary policy and decided on measures to control interest rate rises. The bank adjusted its 'Funds-Supplying Operations against Pooled Collateral' (open market operations), whereby the Bank extends loans to financial institutions, by expanding the loan period to include 10 years or less in order to set lending rates which encourage the formation of a yield curve consistent with the BOJ's financial market adjustments.

At its decision meeting in December last year, the BOJ expanded the allowable range of fluctuation in long-term interest rates around the operational target for the 10-year JGB rate of around 0% from ±0.25% to ±0.5% and partially revised its Yield Curve Control (YCC) operations. Specifically, the bank decided to (i) increase purchases of long-term government bonds, (ii) continue its ' Fixed-Rate Purchase Operations for Consecutive Days' to purchase an unlimited number of 10-year government bonds every business day at a yield of 0.5%, and (iii) conduct these operations at multiple maturities other than the 10-year to correct distortion in the yield curve. However, despite these changes, there was still speculation in the market that the BOJ would shift monetary policy in a tighter direction, and the distortion of the yield curve remained visible, as yield of 8- and 9-year JGBs continued to exceed that of 10-year bonds (Figure 1).

Yuko Iizuka, Economist

"Monetary policy maintained at current level, additional measures decided to curb interest rate rise"

Figure 1: JGB's yield curve



Source: Bloomberg
Note: Dec 19th, 2022 is one day before the BOJ announced the outcome of the Monetary Policy Meeting in December. Jan 17th, 2023 is one day before the BOJ announced the outcome of the Monetary Policy Meeting in January.

In the Outlook for Economic Activity and Prices released on 18 January, the BOJ acknowledged upside risk to consumer prices (excluding fresh food) in the period from FY2023 to FY2024, but kept its outlook in the upper 1% range, below the price stability target of 2% (Figure 2).

"Consumer price outlook for FY2023-2024 remains upper 1% range"

Figure 2: Forecasts of the majority of the Policy Board Members

	CPI (all items less fresh food)	(Reference) CPI (all items less fresh food and energy)
FY2022	+3.0 to +3.0 ＜+3.0＞	+2.1 to +2.1 ＜+2.1＞
Forecasts made in October 2022	+2.8 to +2.9 ＜+2.9＞	+1.8 to +1.9 ＜+1.8＞
FY2023	+1.6 to +1.8 ＜+1.6＞	+1.7 to +1.9 ＜+1.8＞
Forecasts made in October 2022	+1.5 to +1.8 ＜+1.6＞	+1.5 to +1.8 ＜+1.6＞
FY2024	+1.8 to +1.9 ＜+1.8＞	+1.5 to +1.8 ＜+1.6＞
Forecasts made in October 2022	+1.5 to +1.9 ＜+1.6＞	+1.5 to +1.8 ＜+1.6＞

Source: BOJ
Note: The data shows year on year and percentage. Figures in brackets indicate the medians of the Policy Board members' forecasts.
The forecasts of the majority of the Policy Board members are constructed as follows: each Policy Board member's forecast takes the form of a point estimate - namely, the figure to which they attach the highest probability of realization. These forecasts are then shown as a range, with the highest figure and the lowest figure excluded. The range does not indicate the forecast errors. The data doesn't suggest or guarantee any future economic situations, market outlook, other trends related to investment environments, etc.

The next step in monetary policy will be a move towards monetary policy normalization. Practically speaking, we think this is likely to involve the BOJ modifying the wording relating to its easing bias, raising the short-term policy rate, which is in negative territory, raising the 10-year government bond rate target and lifting the YCC framework. The key to this will be developments in the domestic and global economy, price and wage growth, and the exchange rate.

"Will interest rate hikes start in 2024?"

Whilst other major economies, particularly the U.S. and Europe, are in a situation where the probability of entering a recession is high, the Japanese economy is expected to remain resilient due to a recovery in consumption and capital investment. However, some downward pressure on the economy, such as a decline in exports and corporate earnings, is seen as inevitable. Consideration must also be given to the possibility of a sharp appreciation of the yen - which creates downward pressure on corporate earnings - as a result of BOJ interest rate hikes amid a peaking out in overseas interest rates.

The BOJ's emphasis on wage increases will be the focus of the 2023 Shunto or Spring Struggle, annual wage negotiations between large corporations and unions in Japan. RENGO, the Japanese Trade Union Confederation, which represents around 7 million workers, and other trade unions have made demands for significant wage increases, and companies have also announced a series of wage increases. We expect that the rate of wage increases in the Spring Struggle, mainly among large companies, will show clear improvement from around 2% in 2022 and may rise to around 3%. It remains to be seen whether many of the BOJ's deliberative committee members will judge that the virtuous cycle of rising prices and wages has got back on track.

At the Monetary Policy Meeting in October, the need to pay attention to the impact of higher interest rates was pointed out, citing the increase in mortgage borrowing by younger people.

Taking these factors into account, it is difficult to see the BOJ steering monetary policy towards a tighter monetary policy as the U.S. is expected to end interest rate hikes and head into recession. In particular, any interest rate hike is likely to be judged with caution and is likely to be made after 2024.

However with the BOJ due to see a new governor and deputy governor appointed in March/April 2023, market expectation for policy revision remains, and upward pressure on interest rates is expected to continue. As for prices, energy prices, including electricity and gas, are likely to face downward pressure from government measures to curb tariffs, but price increases, particularly for food, are expected to continue into 2023, and the rate of increase in the core CPI is likely to remain high.

Under the new Governor and Deputy Governors, the Bank may make realistic monetary policy revisions, such as changing the YCC framework and making the price target more flexible, after (i) inspecting and validating existing policies when new policies are introduced or revised and (ii) reviewing the “accord”, a joint statement with the Government to work together to achieve the 2 % price stability target (Figure 3 for historical monetary policy developments since 2013 and Figure 4 for a key BOJ timetable going forward).

“Policy modification observations continue ahead of appointments of governor and deputy governors”

Figure 3: Timeline of key BOJ Monetary policy and market events since 2013

Jan-13	Announce joint statement of the Government and the BOJ on 2% inflation target
Mar-13	Haruhiko Kuroda becomes Governor of the BOJ
Apr-13	Introduce "Quantitative and Qualitative Monetary Easing which includes large-scale asset purchases, etc. (QQE)"
Jan-16	Introduce "QQE with a Negative Interest Rate"
Sep-16	Introduce "QQE with YCC"
	Announce Comprehensive Assessment on QQE with YCC
Jul-18	Increase allowable fluctuation range of the long-term interest rate (10-year JGB yield) from ±0.1% to ±0.2%
Apr-20	Strengthen monetary easing to handle COVID-19 pandemic
Mar-21	Increase allowable fluctuation range of the long-term interest rate from ±0.2% to ±0.25%
	Announce Assessment for Further Effective and Sustainable Monetary Easing
	Introduce Fixed-Rate Purchase Operations for Consecutive Days to curb rising yields
Apr-22	Core CPI reaches the level of above 2% year on year
Apr-22	Commence fixed-rate operations to purchase JGBs at 0.25% every business day in principle
Oct-22	Japanese yen weakens to over 150 against the US dollar
Dec-22	Increase allowable fluctuation range of the long-term interest rate from ±0.25% to ±0.50%

Source: BOJ

Figure 4: Important schedule in 2023

January	Convocation of ordinary diet session
February	Personnel information for the Governor and the Deputy Governor is due to be announced
In the middle of March	Date of release of annual wage survey*
March 19th	End of term of Deputy BOJ Governor Amamiya
March 19th	End of term of Deputy BOJ Governor Wakatabe
April 8th	End of term of BOJ Governor Kuroda

Source: Published news, etc.
Note: *Release date of results of survey conducted by the BOJ on planned annual wage hikes in the private sector in Japan.

Disclaimer

For this Presentation Material

- This documentation was prepared by Asset Management One Co., Ltd.
- This documentation is required to be used only by the investor to whom it is distributed.
- This documentation is only for the purpose of providing information and is not intended to be used to solicit investments.
- This documentation was prepared using data that Asset Management One Co., Ltd. has judged to be reliable including data from third-party sources. However, Asset Management One Co., Ltd. does not guarantee its completeness or accuracy. Additionally, the published data are only indicative of past performance and do not provide a guarantee of future performance.
- The contents included in this documentation are only current as of the date this documentation was prepared (January 25, 2023) and are subject to change without notice.
- The intellectual property and all other rights pertaining to the data published in this documentation including benchmark indices shall remain the property of the publisher and licensor.

22-044 GBDG