【Fixed Income Commentary - Monetary Policy Navigator】

BoJ stands pat, takes cautious stance citing “extremely high uncertainties”

(original Japanese report issued on October 29, 2020)

Key points

- BoJ maintains status quo at October meeting, no deadline extension for special coronavirus measures as some media outlets speculated
- Outlook report scenarios largely unchanged, again warned about “extremely high uncertainties”
- Extension for corporate financing support measures, including special coronavirus measures, possible at Dec meeting after government formulates stimulus steps

No policy changes for third straight meeting, no deadline extension for special coronavirus measures

The BoJ Monetary Policy Board decided to leave policy unchanged when it met on October 29 (Table 1). Specifically, the Bank left its short-term policy rate at minus 0.1% and its 10-year JGB yield target at “around zero percent,” while reiterating its pledge to “purchase a necessary amount of Japanese government bonds (JGBs) without setting an upper limit.” It also left in place the heightened ceiling on its asset purchases, again saying it would “actively purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) for the time being so that their amounts outstanding will increase at annual paces with the upper limit of about 12 trillion yen and about 180 billion yen, respectively.” Some media outlets reported that the BoJ is mulling an extension for its Special Program to Support Financing in Response to the Novel Coronavirus (currently set to run until end-Mar 2021), but no such announcement was made at this meeting. The Bank reiterated its intention to conduct additional purchases of commercial paper and corporate bonds with the upper limit of the amounts outstanding set at 7.5 trillion yen for each until end-March 2021. These results were in line with the market consensus and our expectations.

Table 1: October BoJ meeting: Policy left on hold for third straight time

Yield curve control 【Unchanged Votes: for 8, against 1 (Mr. Kataoka) 】	
Short-term policy interest rate	Minus 0.1%, applied to the Policy-Rate Balance in current account
Long-term policy interest rate	The Bank will purchase a necessary amount of JGBs **without setting an upper limit** so that 10-year JGB yields will remain **at around zero percent.** While doing so, the yields may move upward and downward to some extent mainly depending on developments in economic activity and prices. (Note: In case of a rapid increase in the yields, the Bank will purchase JGBs promptly and appropriately.)
Guidelines for asset purchases 【Unchanged (unanimous vote) 】	
ETFs and J-REITs	**The Bank will actively purchase ETFs and J-REITs for the time being so that their amounts outstanding will increase at annual paces with the upper limit of about 12 trillion yen and about 180 billion yen, respectively.** (Note: As for the guideline for purchases of ETFs and J-REITs, in principle, "the Bank will purchase these assets so that their amounts outstanding will increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively. With a view to lowering risk premia of asset prices in an appropriate manner, the Bank may increase or decrease the amount of purchases depending on market conditions.")
CPs and corporate bonds	As for CP and corporate bonds, the Bank will maintain their amounts outstanding at about 2 trillion yen and about 3 trillion yen, respectively. **In addition, until the end of March 2021, it will conduct additional purchases with the upper limit of the amounts outstanding of 7.5 trillion yen for each asset.**
Policy guidance —Unchanged	
Continuation of YCC	The Bank will continue with "Quantitative and Qualitative Monetary Easing (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. **【Introduced in Sep 2016】**
Inflation-overshoot commitment	It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all item less fresh food) exceeds 2 percent and stays above the target in a stable manner. **【Introduced in Sep 2016】**
COVID-19 measures	The Bank will continue to support financing mainly of firms and maintain stability in financial markets through (1) the Special Programto SupportFinancing in Response to the Novel Coronavirus (COVID-19), (2) an ample provision of yen and foreign currency funds without setting upper limits mainly by purchasing JGBs and conducting the U.S. dollar funds-supplying operations, and (3) active purchases of ETFs and J-REITs. **【Introduced in Apr 2020】**
Stance on additional easing	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. **【Revised in Mar 2020】**
Forward guidance for policy rates	(A) nd also it expects short-and long-term policy interest rates to remain at their present or lower levels. **【Revised in Mar 2020】**

Source: MUMSS, from BoJ materials

No big changes to Outlook report's baseline scenario, brighter assessment for production / exports

Along with the results of its Monetary Policy Board meeting, the BoJ also released its Outlook for Economic Activity and Prices (Outlook report). This report opened with the Bank's assessment that, "Japan's economy is likely to follow an improving trend with economic activity resuming and the impact of the novel coronavirus (COVID-19) waning gradually, but the pace is expected to be only moderate while vigilance against COVID-19 continues." As for the outlook, the report again stated, "As the impact subsides globally, the economy is projected to keep improving further with overseas economies returning to a steady growth path." Among individual demand items, the BoJ raised its assessments for exports and industrial production to "have increased" from "have turned to a pick-up" as of the September meeting. Its assessment of business sentiment was also raised from "has deteriorated" previously to "deteriorated significantly but subsequently has improved somewhat."

FY20 real GDP revised lower, core CPI reflects *Go To Travel* impacts

The economic and price forecasts made by Policy Board members are as shown in Table 2. The median FY20 real GDP forecast was cut to -5.5% from -4.7% as of July. This reflects the steep 28.1% QoQ annualized contraction for Apr-Jun real GDP, as well as a delayed recovery for service demand. Outlooks were nudged higher for FY21 (from +3.3% to +3.6%) and FY22 (from +1.5% to +1.6%). The FY20 core CPI forecast was lowered to -0.6% from -0.5% in the July report, as lower lodging prices due to the government's *Go To Travel* campaign were not reflected in the forecasts as of July, as the media reported before the release of the October report. The FY21 core CPI forecast was raised from +0.3% to +0.4%. The BoJ said that the direct effects of the *Go To Travel* campaign on the CPI are estimated to be -0.2%pt for FY20 and +0.2%pt for FY21, based on assumptions such as the period (i.e., from August 2020 through January 2021). The FY22 core CPI forecast was unchanged at +0.7% (Graph 1).

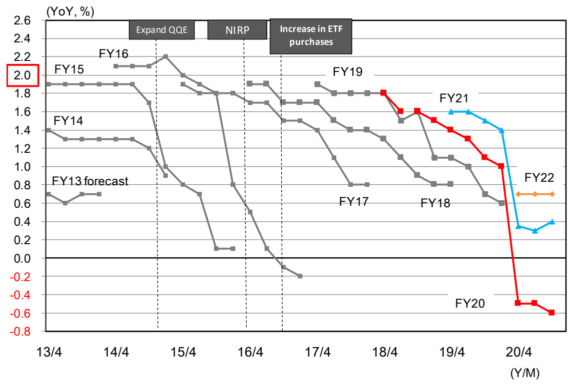
Table 2: Forecasts of the Majority of Policy Board Members

(%, the median forecast, the forecast ranges of the majority members are in parentheses)

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hike and policies concerning the provision of free
FY20	-5.5 < -5.6 - -5.3 >	-0.6 < 0.4 - 0.7 >	-0.7 < -0.8 - -0.6 >
July	-4.7 < -5.7 - -4.5 >	-0.5 < -0.7 - -0.3 >	-0.6 < -0.7 - -0.5 >
FY21	3.6 < 3.0 - 3.8 >	0.4 < 0.2 - 0.6 >	
July	3.3 < 3.0 - 4.0 >	0.3 < 0.2 - 0.7 >	
FY22	1.6 < 1.5 - 1.8 >	0.7 < 0.4 - 0.7 >	
July	1.5 < 1.3 - 1.6 >	0.7 < 0.5 - 0.8 >	

Source: MUMSS, from BoJ materials

Graph 1: BoJ's (median) core CPI inflation forecasts



Source: MUMSS, from BoJ, Japan Center for Economic Research

Cautious stance on outlooks citing "extremely high uncertainties"

Regarding the baseline scenario (continued improving trend for economy, price recovery), the BoJ again said that the outlook for economic activity and prices is "extremely unclear, since it could change depending on the consequences of COVID-19 and the magnitude of their impact on domestic and overseas economies." The Bank also warned, "The outlook is based on the assumption that COVID-19 will not spread again on such a large scale that wide-ranging public health measures will need to be reinstated. It also is based on the premises that, while the impact of COVID-19 remains, firms' and households' medium-to long-term growth expectations will not decline substantially and the smooth functioning of financial intermediation will be ensured with financial system stability being maintained. However, the assumption and premises entail high uncertainties."

Maintains its "minimizing the maximum risk" approach

That said, the number of coronavirus cases in the US and Europe are, at this moment, again rising. Indeed, on October 28, French President Emmanuel Macron announced a new nationwide lockdown until December 1 to curb the coronavirus spread. German Chancellor Angela Merkel likewise announced that eating/drinking establishments and leisure facilities will be shuttered from November 2. Japan has managed to avoid another increase in coronavirus cases like that seen in the US and Europe. However, any slowing of the recovery pace for overseas economies could impact production activities in Japan through reduced overseas demand. Also, there is a growing sense of nervousness ahead of next week's US presidential election, evidenced by the steep pullback for US and European stock markets on October 28. Recently the yen has gradually appreciated and was trading in a USD/JPY104.0-104.5 range in Tokyo on October 29. We assume that these developments are disconcerting for the BoJ. For now, the BoJ will likely continue conducting its monetary policy with the "minimizing the maximum risk" approach it adopts whenever uncertainties are high. At this juncture the biggest risks are a pullback for the real economy, along with financial instability and the reemergence of deflation.

Earnest additional easing hinges on fiscal policy

As noted in our October 27 *Monetary Policy Navigator* (Japanese only), from a global perspective, the potential for additional monetary policy easing will strengthen depending on fiscal policy conditions. We note that the BoJ already holds more than 40% of outstanding JGBs. If the government decides on additional expenditures requiring increased JGB issuance, that would generate room for increased JGB purchases by the BoJ. However, increased JGB purchases without such moves by the government could have the unwanted effects of lower JGB yields and undermined market functions. Meanwhile, there is the risk that moving the short-term policy rate deeper into negative territory could increase unwanted side effects for financial intermediary functions.

Extension of corporate financing support measures possible at Dec meeting

In this manner the BoJ, which has limited means to deal with a host of risk factors, must make policy decisions while considering the expectations placed upon it by markets and citizens. The Suga Cabinet has indicated that it will officially formulate additional economic stimulus measures in November. We expect these measures to be finalized in December followed by the preparation of a third supplementary budget. The BoJ is currently supporting corporate financing by raising the upper limit for its CP and corporate bond purchases, as well as through its Special Program to Support Financing in Response to the Novel Coronavirus. We believe that the Bank could decide to extend the periods for these measures (Table 3) at its next Monetary Policy Board meeting on December 17-18.

Table 3: Overview of main BoJ easing / corporate financing support measures

Main easing policies	Amount or ceiling	Duration of program
Further active purchases of JGBs	Unlimited	No deadline
Active purchases of ETFs and J-REITs	ETF: 12.0 trillion yen (+6.0 trillion yen) J-REIT: 180 billion yen (+90 billion yen)	For the time being
COVID-19 operations	About 110 trillion yen (Note)	Until the end of Mar 2021
Increase in CP and corporate bond purchases	CP: 9.7 trillion yen (+6.5 trillion yen) Corporate bonds: 10.7 trillion yen (+6.5 trillion yen)	

Note: Up to the total of "eligible loans" and "private-sector collateral value", thus not fixed.
Source: MUMSS, from BoJ materials

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14:30 JST, October 29, 2020

Appendix A

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